MODERN BUSINESS



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Modern Business

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AND FIRST EDITOR-IN-CHIEF
OF THE

MODERN BUSINESS SERIES

Credit and Collections

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PREFACE

The part that credit plays in the general organization of modern life is portrayed in the Text on "Economics—The Science of Business." In the present volume credit appears as a phase of business management. It is the purpose of the Text to show the general principles which underlie the granting of credit as well as the business organization in its various aspects, which has made possible the conduct of business on a large scale upon the basis of credit.

It is recognized that only one-half the story is told when credit is granted, that it is not complete till the promised money has been collected. Collections indeed are so intimate a part of credit operations that they can not be severed from it except by a crude mental surgery. They occupy, therefore, a considerable space in the present treatment.

In the preparation of this Text, the writers have drawn upon many sources of opinion and experience. They are largely indebted, for valuable material and counsel furnished, to Mr. Walter S. Johnson of the Montreal Bar, to Mr. George P. Woodruff of the Alexander Hamilton Institute, to Mr. Alexander Wall, Secretary-Treasurer of the Robert Morris Associates, Lansdowne, Pa., and to Mr. E. B. Moran

of the Credit Interchange Bureau of the National Association of Credit Men at St. Louis.

It is, furthermore, a pleasure to record our sincere obligations to our special collaborator, Mr. David E. Golieb, Treasurer, Einstein-Wolff Company and Chairman, Executive Committee, National Institute of Credit. Every line of the work has received his careful scrutiny, and his numerous suggestions for its improvement have been embodied in it.

DWIGHT E. BEEBE
T. VASSAR MORTON

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CREDIT AND COLLECTIONS

CHAPTER I

MERCANTILE CREDIT

1. *Growth of credit in modern business.*—At the outbreak of the European War in 1914 numerous predictions were made that the struggle must of necessity be a short one thru sheer inability of the nations to carry the terrific financial burden for any length of time. The same reasoning would have had every nation bankrupt before two years had elapsed; yet the finish found the great nations still solvent, carrying financial burdens of a magnitude previously unheard of. If it had been necessary to finance the war thru cash payments, predictions of early bankruptcy would have been more than justified. The same machinery of credit, however, that permits the development and expansion of business enterprises into the millions of dollars has permitted national financing in terms of billions. Thru the entire growth of business and industry, credit has gradually been assuming a more and more important place as a means of settling business transactions. This development has now

reached the point where all but a small fraction of the world's business is transacted with credit as the means of exchange, altho the transactions are measured in terms of money. Thru credit the transfer of funds to cover every individual transaction is obviated, the volume of business is greatly increased and the extent of operation both by buyer and seller greatly enlarged.

2. *Meaning of credit.*—When credit is extended, one person or business house buys goods or renders services in return for a promise to pay for these goods or services at some future time. Credit, then, is an exchange of goods or services for a future promise to pay. It is this latter element of the transaction that comes up for examination whenever credit is extended. What is the value of this promise to pay? Is it fortified by such reasonable assurances that a man may safely sell his goods or render his services without receiving the actual cash at the time of the exchange?

3. *General and individual aspects of credit.*—The place which credit occupies in the economic world has been discussed in the Modern Business Text on "Economics." The burden of that discussion is what credit does for the world at large, how it has made possible the development of production and wealth. In thus considering credit it appears somewhat as an abstraction, remote from the affairs of the individual. Again, it is some of the broader aspects of credit which will find consideration in other Modern Business Texts.

The purpose of the present treatment is to con-

sider credit as a phase of business management. It is more concrete, more definite, more intimately related to the business problems of the individual whether he is concerned with the question of granting credit or whether as an applicant for credit he seeks to validate his request. It will not be the credit applicant, however, but the credit giver who occupies the center of the stage.

The problem which will engage our attention is how the manufacturer or the merchant decides whether or not a given applicant is to receive the credit he asks. This is a vital question in the conduct of business since injudicious credit granting may wreck an enterprise. We have to examine, then, the principles according to which a decision is reached, and the safeguards which business practice has erected to insure a wise decision.

The discussion of credit, therefore, will not be abstract and general, but will concern its concrete and individual application. It is neither the general economic aspects of credit, nor the purely personal phases of the question which will occupy us but the business side of credit—in short, mercantile credit—with which we shall have to concern ourselves.

The granting of credit in the business world, whether by manufacturers, merchants or banking institutions, is determined by a consideration of the merit of the applicant and by a regard for general business conditions. It is especially to the elements which enter into the merit of the applicant, the means

taken by the credit giver to discover precisely what it is, as well as the procedure of granting credit, and making the collections which necessarily follow it that the present treatment is devoted.

4. *Why does a business use credit?*—The convenience of credit has been an important element in extending its use by consumers. The house that sells the consumer, however, is also a user of credit possibly running into thousands of dollars. The manufacturer who sells to the middleman or the retailer is carrying in turn perhaps hundreds of thousands of dollars of accounts payable. Business houses, like the individual, may find credit a convenience, but what causes them to use the convenience so extensively?

Suppose a partnership having an invested capital of $100,000 sells for cash and pays immediately for its purchases. This is a sound enough way of doing business but it is also an unnecessarily cramped way. So far as the firm's selling field is concerned, if at any one time it has 2,000 possible customers and of this number 600 cannot or do not wish to buy on cash terms, it must lose these prospects to other houses which will extend credit to them. Its ability to take care of increasing demands of its customers is restricted also. So long as it buys only for cash it cannot care for the requirements of a larger market than its own capital can finance. A successful business cannot be static. It must increase or slip back. If the $100,000 partnership changes its terms from cash to credit it straightway widens its market, but

in order to provide for the increasing needs incident to such extension it must increase its own purchasing power; it therefore augments its capital by borrowed capital. It buys on credit. Business uses credit, then, because it permits greater activity, larger volume and the selling to a wider field than individual capital can finance.

5. *Elasticity of credit.*—A second reason for the widespread use of credit is its elasticity. Invested capital cannot be readily expanded or contracted, while credit allows changes to be made to conform with and in anticipation of changing conditions. Applied to the everyday affairs of a business, it permits the expansion of operations when business is booming and a contraction in periods of dullness. More than this, thru it favorable conditions may be anticipated. A business may be stagnant during the summer, yet the owner may be almost certain that the fall will bring a demand for more goods than its own capital will enable it to supply. Thru the use of credit the house is able to provide to meet in full this anticipated demand.

Finally, credit, judiciously used, is a cheaper and more efficient means of carrying on a business than the exclusive use of owned funds. A $100,000 business which owns all its invested capital may make a profit of $8,000 in a year, or 8 per cent on the money invested. If the same business is carried on with $60,000 of owned funds and $40,000 of borrowed funds, it then would make $8,000 less $2,400 (6 per cent

interest on the borrowed money) or $5,600, about 9 per cent on $60,000. By the use of borrowed funds the earnings on the owned capital are increased from eight to nine per cent and the owners have their $40,000 for employment elsewhere. This phase of credit —the direct borrowing of money—is treated in other Modern Business Texts.

By intelligent use of credit a mercantile concern with a given amount of capital can increase its sales; this means a decrease in the percentage of overhead expense. A manufacturer, too, by expanding his plant facilities, can increase production with a consequent reduction in unit cost. Thus the same result is achieved under both practices.

6. *Limitations to credit.*—Like other good things credit can be abused. The granting and the obtaining of credit must always be gauged by the possibilities of the market at any given time and by the measure of the applicant's working capital. Buying extensively on credit may be placing a house in a position to do a large business, but if there is no demand for the goods the effect is only to saddle it with heavy inventories which cannot be moved and probably with burdensome liabilities. Similarly selling to dealers indiscriminately on credit builds a large temporary trade for a manufacturer or jobber, but if the buyers cannot move the goods from their shelves, an impasse has been reached that can only be overcome when the gorged market has absorbed by sale to the ultimate consumer the oversupply it has been led to purchase.

Broad policies of granting credit freely or contracting it, obtaining it increasingly or reducing it, must be governed, then, by a consideration of the market that is served. This aspect of credit, call it credit policy, is concerned with the advisability of increasing or contracting the house's total credit obligations receivable or payable at any given season. Subordinate to this broad policy comes the everyday work of granting credit to the individual. Here the questions that determine the general policy are concentrated on the applicant. The question is no longer one of the general market; it is one of the individual, firm or corporation. Given everything else in favor of an increasing credit business, what is it that will entitle the applicant to be included in that business?

The seeker of credit does not come in the rôle of a supplicant, but neither is he entitled to credit without establishing his right to it. Every prospective customer is welcomed, but when he applies for credit he is asking for a short loan of part of the seller's capital. The business house, then, follows a procedure analogous to that which a bank would follow in cashing a check for a stranger. It wants to know who the stranger is, whether the check is good, and whether he can reimburse it in case of mistake before it parts with any of its money.

7. *Main points to determine credit.*—Credit has been defined as an exchange of goods or service for a promise to pay in the future. It is evident that the main consideration of the credit man is devoted to

determining the worth of the promise. The buyer must conform to certain standards; his business must be able to endure certain tests. He is to receive goods upon his promise. A sale upon a promise that does not come up to these standards is not granting of credit at all. It is simply bad business. The possession of written promises to pay can never take the place of a thoro and adequate determination of the worth of the debtor's promise for, after all, a note or an acceptance, in its legal effect, is only the buyer's verbal promise reduced to writing. The written instrument as such is not security. Regardless of the means by which the transaction has been effected, should the buyer's promise be bad, the seller is left in the position of having parted with his goods in exchange for something which may be worthless, and which in any event he will be put to much trouble to realize upon.

In simple form the three questions that the seller asks himself about the prospective buyer are: Is he honest? Has he business ability? Has he sufficient resources? These questions go to the root of the matter of determining a buyer's credit.

In addition to the three elements of character, business ability, and capital already indicated, a fourth measure of consideration might be added and that is the form of the buyer's enterprise. If the buyer is a corporation, the assets actually owned by it are the only ones to which the creditor may look in case it becomes necessary to force collection of the debt

at law. The stockholders cannot be counted upon to aid it with their personal resources in case of any unforeseen trouble. An individual or a partnership, however, is fortified not only by its own capital but by the private resources of the individual or the members of the firm. The unlimited personal liability of the individuals and general partners for the debts of their businesses is a strong incentive to them to employ every means for successful operation. If the business gets into serious difficulty, the private estate of the individual partner is endangered. Assuming equality between a partnership and a corporation in regard to the three major factors already indicated, the former is entitled to a greater measure of credit than the latter because of the personal liability of its various members. When, however, some of the directors or stockholders pledge their outside resources for additional credit, the situation is altered.

8. *Methods of granting credit.*—Credit is always granted upon the promise of the buyer. That promise may either be implied as in the case where a customer "charges" a purchase at his retail grocer, or it may be expressed, that is, evidenced by a written instrument. The written promise may take the form either of a promissory note or a trade acceptance or draft. In the note the buyer gives the seller his written promise to pay within a specified time. In the trade acceptance or draft, the seller draws an order on the buyer for the amount of the sale, and by "accepting" this draft or trade acceptance the buyer

agrees to fulfil the order. The buyer's acceptance is in effect his promissory note.

9. *Credit affected by general trade conditions.*—The prime factors that influence the granting of credit and the amount that will be extended have been already indicated. These are the factors that are individual and rest entirely upon the condition of the business of the credit seeker. So closely interwoven is the modern fabric of business, however, that general conditions, whether of prosperity or depression, have at all times a vital influence upon the extent to which credit may be granted. It is as true of money and credit as of any commodity that when it is plentiful its price falls and it is comparatively easy to obtain. Conversely, when money becomes scarce, merchants cannot obtain it so easily or under such favorable terms. The result is that merchants cannot tie up so large a proportion of their goods in credit transactions as they could in times when money was more easily obtainable. The volume of general credit has contracted and in the same way the individual business house's buying power is curtailed.

10. *Turns of the business cycle.*—Over any extended period of years it will be seen that there have been times of great prosperity and periods of reaction or "hard times." Mercantile credit is concerned with this swing of the business cycle or at least it ought to be. During a period of prosperity all business is riding at the top of the tide. Railroad earnings are large, building operations are being carried on exten-

sively, bank clearings show a great increase and the volume of the deposits shows a considerable growth. During such a time, with prosperity everywhere, credit is widely asked for and granted freely. Stimulated by the "boom," manufacturer, wholesaler and retailer add to their stocks, relying on the rise of prices for greater and greater profit. Such a condition causes larger buying on credit since each class is out to reap its full share of the prosperity.

In turn, when with plants working at capacity, the various markets become glutted, there being a superabundance of goods, prices commence to fall. The same scramble that ensued when prices were rising now takes place, only with a different purpose. Where before dealers were anxious to purchase largely in order to turn large profits, now they are anxious to sell at once in order to save themselves against too heavy losses. It is in times such as this that business houses which have made purchases of stocks on wide margins of credit often find that falling prices will net them not the profit they had anticipated, but an actual loss.

The problem of the credit man is not merely trailing with the times, granting credit freely when it is asked freely and contracting when business in general contracts, but it is anticipating these times. In a period when all is optimism and business is apparently swinging indefinitely upward in a rush of prosperity the far-sighted credit man will, by studying external factors, prove his worth to his house

by anticipating just how near the crest of the wave of prosperity the business craft has risen. The credit man who can hold his buyers to reasonable margins before the ebb sets in and who does not find himself with a great burden of accounts receivable in a time of depression is a valuable executive. He combines the acumen and the skill of his own work with the ingenuity and foresight of the banker.

11. *Place of the credit man in the business.*—The credit man himself can never lose sight of the fact that he is performing only one function of the business enterprise—that he is not standing alone. The most important work of a business is selling, but it is equally important that it make a profit from its sales. Laxity on the part of the credit man may result in a loss of profit thru permitting bad accounts to get on the books. Yet overstrictness often means loss of customers who, not the highest credit risks, are nevertheless good. The credit man has to steer a middle course. Cooperation is as important a part of his duties as standing guard. A credit man whose company had a number of traveling men on the road found that he was not gaining any great popularity with the salesmen due to the fact that every now and then he was compelled to turn down orders from houses to which the salesmen had sold. Aside from the loss of personal popularity it struck him that such practice resulted not only in wasted effort on the salesman's part but loss of good-will of a customer whose condition might subsequently improve. The

solution was soon found. Thereafter a plan was worked out whereby the credit man was notified in advance of the territory into which the different men on the road were going. He was then able to go over the entire field of houses in that particular line in the territory and tell the salesmen in advance who were the good credit risks and those to whom credit should not be offered. This credit man became a sales builder thru providing the salesmen in advance with a select list of customers.

Not only must the credit man be able to cooperate with other departments, and be a student of trade and business in his ability to foresee changes in the general business conditions, but thru it all he must be a diplomat. He has it within his power to drive old customers away or to educate the recalcitrant customer so as to earn his everlasting good-will. It is with these various phases of the credit man's activities that the body of this work will deal.

REVIEW

Distinguish between personal and mercantile credit.

Why is it ordinarily more profitable for a merchant to do business on part borrowed capital than on capital all his own?

What are the considerations to be kept in mind by the seller in determining what amount of credit to extend?

Outline briefly the relation between mercantile credit and the turns of the business cycle.

NOTE: The review questions thruout this Volume are for the personal convenience of the reader in testing his understanding of the chapter. It is not necessary or desirable for subscribers to submit written answers to the Institute except in a case where they may feel uncertain as to their grasp of the question under consideration.

CHAPTER II

BOOK CREDIT

1. *Development of book credit.*—Probably the most familiar method of selling goods on credit is by what is known as "book credit." Here the goods pass into the hands of the buyer after the fact is duly established that he is properly entitled to credit, and the seller bills him for the amount of the invoice at the terms which were agreed upon at the time of sale. The term "book credit" is used because the sole tangible evidence of the transaction is that which is contained in the seller's books of original entry. While book credit is ancient, its greatest growth has been during the past sixty years. Previous to that time the bulk of sales were made on bills of exchange, the prototype of the trade acceptance of today.

The growth of book credit has some historical interest. All of our legal, commercial and social customs were carried over from the mother country at the time of the separation in 1776. The acceptance has long been the most familiar credit instrument in England and on the European Continent, and up to the time of the Civil War it enjoyed a steady growth in this country. The conflict between the States brought in its train unsettled credit conditions and

higher interest rates. Ready money was hard to obtain. A condition of this sort naturally fostered the offering of inducements to buyers to make settlement in cash. With high money rates the seller was no longer willing to wait for the buyer to meet the usual acceptance or draft. He needed the money immediately and this resulted in the birth of the cash discount. The seller preferred to obtain the money immediately even at the cost of offering a considerable discount from the gross quotation rather than to wait.

The practice of carrying buyers on open book accounts grew steadily and today the open book account with the cash discount privilege forms the major part of our credit transactions. Improved communication facilities, the development of the railroads, telegraph and telephone also served to bring buyer and seller into close touch with one another. The improvement in banking accommodations also played a prominent part in the growth of selling on open book account. With commercial banks in practically every community, the buyer was able to borrow from the bank at the prevailing interest rate and take advantage of the heavy discount terms offered.

2. *Nature of the open book account.*—When a sale is made on an open book account, there is a promise to pay on the part of the buyer. This promise may be fortified by letters if there has been correspondence regarding the sale and such correspondence can be put together so as to piece out a contract.

Oftentimes, however, the seller's books of original entry are the only evidence of the transaction. The open book account sale, in such cases, is a sort of "gentleman's agreement." The buyer obtains the goods and in return the seller has the implied promise of the buyer to pay for them. Such a "gentleman's agreement" is all right—if the buyer is a gentleman. Complications necessarily arise, tho, if he is not, or if he is prevented from acting as one by circumstances outside of his control. Here the seller has only his own books to rely upon. If it is ever necessary to go into court to collect the bill, the buyer may assert that the goods were not received, that they were damaged all or in part, or that the terms of sale were different from those which the seller asserts. The buyer may assert that the goods were sent him on a consignment sale (only those goods which were sold to be paid for) or he may set up a counter-claim, alleging that some other transaction was to offset the amount of the seller's bill in whole or in part. Yet it must be pointed out that much of the above difficulty can be avoided if the vendor requests written confirming orders. Formal contracts are being used in many instances today; these assure protection.

3. *The open book account; economic objections.*— Such a system has its obvious faults. Many of them have been recognized clearly for some time. If an analysis of this method of selling were attempted it would be possible to group the objections to the open book account as economic and ethical. Under the

head of economic objections are the facts that on open accounts (1) the seller is compelled to act as a banker for the buyer; (2) the capital value of the merchandise remains buried in the goods for the life of the credit term; and (3) the lack of a sharply defined time for the payment of accounts has been a fruitful source of business failure thru the tendency to over-buy.

If Smith sells goods to Brown on 60 days time he is acting as Brown's banker. Of course, Brown does not get an actual loan of money but he obtains the loan of capital represented in the goods. It may be pointed out that Smith can go to the bank, discount his own notes and finance himself. He can do this, of course, but he still remains Brown's banker, for the note he discounts at his bank is one for which he has to pledge his general credit. The capital he has in the goods remains buried in them until Brown pays his bill. It has been well said that "An outstanding account represents money tied up which cannot work."

If it becomes necessary for a seller to pledge his accounts receivable with a banker or broker, he will have even more capital tied up. The great objection of over-buying and over-selling is no less important to the general business of the country than the tying up of his capital is to the individual seller. In sales on open book account it is understood that payment is to be made in a specified time. There is no written instrument to evidence that fact, however, and

this, in itself, produces laxity. If the buyer is unable to pay promptly in sixty days, he may run on for a fortnight or a month more without getting into trouble. On the other hand, if Brown knows that he has a definite obligation to meet at a certain time, he is not so likely to allow his buying eyes to become greater than his selling stomach. If he has the feeling that he can meet his obligations practically at his will, there is no tangible check to his enthusiasm for new goods shown him.

The same indefiniteness that encourages over-buying is also a tendency to over-sell. When a man loans another money on a note, his first thought is, "Can this man pay his note when it falls due?" The same consideration is found in the sale of real estate where a mortgage is taken as part of the purchase money.

4. *The book account; ethical objections.*—Among the criticisms that can be levelled at the book account from the ethical standpoint are the facts that the cash discount gives the large dealer an advantage over the small, and that the door for litigation is left wide open, inasmuch as the seller has only his book account as evidence of the transaction. He has no definite record of the state in which the goods were received and the integrity of the shipment.

The cash discount is undoubtedly an aid to the big dealer. A man doing a business of $500,000 may be carrying on his enterprise on no stronger lines than a man doing a business of $25,000. The economic

condition of both enterprises may be exactly the same. The big dealer, however, commands better credit facilities. Then, just as the credit term is often taken advantage of thru the buyer taking a much longer time for payment, the discount privilege may be abused. The actual time for the taking of a discount may have elapsed but if the seller is greatly in need of cash, he will be apt to permit the buyer to take advantage of the cash discount in order to obtain the funds which he needs. In short, the open book account is a two-edged sword in the hands of the buyer. Having both the seller's goods and his own money, he enjoys all of those intangible nine points of the law that go with possession. The seller, of course, has ample remedies to enforce his claim. But goods are not sold with litigation in view as a means of collecting on them. A single sale means nothing to a business house. What it is trying to do is to build up a list of customers who will be steady buyers and for this very reason, the selling house can ill afford to take measures that will alienate the goodwill of individual buyers, even when the action of the buyer reduces them to a point of exasperation.

Good business practice, however, demands that the seller resist all attempts to violate terms and conditions which by force of established custom he is relied upon to apply uniformly in fairness to all his customers. As much as he may be inclined to indulge the customer the seller should use the utmost discretion in yielding.

The buyer's over-buying may even be deliberate. This may, of course, be done with deliberate fraudulent intent, but this is not the sort of over-buying that is the greatest danger to the credit man. For the deliberate fraud will usually not pass the tests of character, ability and capital that will be put to him and so not be in a position to obtain goods with intent to defraud the seller. The dangerous kind of over-buying is apt to come from houses whose credit has already been established but which find themselves slipping into precarious financial difficulties. How is over-buying going to help such a house? Suppose a concern finds that its capital is running short and that in the future it may have to curtail its operations to a considerable extent in order to get along. Anticipating difficulties in the future, the buyer lays in heavy stocks of goods. The anticipated difficulties come and the buyer is short of working capital. The burden, however, falls upon those who have sold him. The company must raise money, obtain extensions from creditors or go under. With the prospect of the buyer going into insolvency and the consequent shrinkage of accounts to a fraction of their worth on the dollar, the creditor is practically compelled to extend the time for payment of accounts. The open book account method of trading, lends itself more readily than the acceptance method for the buyer deliberately to place the creditor in a position where he must extend the time of payment indefinitely, or

see his receivables shrink as the buyer goes thru the slow and costly processes of bankruptcy.

5. *Checking abuses of credit terms.*—The broad question of the desirability or otherwise of the book account is a matter of policy for the house. With the book account in use, the credit man is chargeable with seeing that customers do not take liberties with it. Two of the most frequently occurring problems are those connected with the abuse of the discount privilege and the matter of past due accounts.

A cash discount is not simply a haphazard device for inducing a buyer to pay cash within a short time. It is, or it ought to be a credit, mathematically calculated, by which the extra charge to cover the seller's expense and risk on a credit sale is reduced. Let us see what elements enter into this extra charge. In the first place there is the matter of interest. So long as the buyer has the seller's goods without paying for them, the seller is losing interest on this part of his capital. Accordingly, if money were at six per cent, goods worth $100 cash, if sold on three months' time, would properly be worth $101.50 to cover the item of interest alone. Not only does the seller have this expense; on every credit sale he incurs a risk—the risk of non-payment or delayed payment. In addition to a premium to cover interest, then, the seller adds a charge for this risk in fixing the price for a sale of goods on time. What this premium for the risk is must be a matter of calculation from

the experience of each business. The proportion that dead losses, with their attendant expenses, plus interest lost thru failure of buyers to pay within proper time bear to net receipts will determine the premium that the house must add to pay it for the risk involved in its credit sale. When the buyer anticipates payment in case of a sale made on time he reduces the amount of interest lost to the seller and removes that particular transaction from the seller's burden of risk.

A cash discount, then, is an exactly calculated credit given to the buyer when he pays within a specified time. Suppose he does not pay within that time but nevertheless deducts the discount. This may be regarded as sharp practice and it is, moreover, a pecuniary loss to the seller if he permits the buyer to take advantage of him in this way. A firm stand can be taken in such manner as to check the abuse where it tends to crop up, and at the same time the good will of the customer need not be alienated. He is on indefensible ground and he knows it.

6. *Past due accounts.*—If the seller is a loser when an unearned discount is taken, he is also a loser when the buyer drags along and permits his account to stand weeks or months after his credit term has expired. This is a problem that needs attention. The creditor is losing the use of his money and his risk is being prolonged. The question is how best to remedy the situation, and the condition is slightly different from the taking of the unearned discount. All those who do not pay promptly are not necessarily

delaying because they want to hold the amount of the account for their own use as long as possible. Circumstances may have embarrassed the debtor temporarily. On the one hand there is the desirability of reducing slow pay accounts to a minimum. On the other hand there is the matter of preserving the customer's good will, assuming him to be desirable.

Charging interest on past due accounts is a practice that has wide advocacy. It is not always done and its efficacy may be open to question. If the interest is not paid when the account is finally settled, the house must continue to haggle over what is likely to be a small amount. The remedy for curtailing slow pay accounts appears to lie rather in a limitation of the amount of credit granted. If a man with a credit limit of $1,000 cannot pay his bills promptly that limit should be reduced without delay. The customer's trouble may be over-buying and a curtailment of his credit may act favorably toward improving his business methods.

7. *Raising money on accounts receivable.*—A business selling on open account customarily resorts for its funds to its general line of credit at the banks. There are, however, methods by which the accounts receivable may be used directly as a basis of credit accommodation. These methods may be adopted for any one of the following reasons: (1) the company may be in financial straits and need more money urgently; (2) it may wish to expand its business to a greater extent than its line of bank credit permits;

(3) a new business may find this the most expedient method of obtaining credit; and (4) an old established business may borrow in this way to discount its current purchases.

With regard to the first reason little needs to be said. A company hypothecating its accounts to keep solvent does so at a heavy discount and the practice in such cases is a last resort to keep from going under. There is, however, a type of credit corporation which functions not so much as a pawn broker for the needy, but as an adjunct to the commercial bank.

8. *Operation of the credit companies.*—Suppose that for some reason it appears desirable for a business to enlarge its credit by using its accounts receivable. The accounts are assigned to the credit company which usually advances part of the amount for which they are pledged and pays the balance, less its interest charge and premium, when the pledged accounts have been paid. The proportion of the cash advance and the deferred payment is customarily eighty and twenty per cent. Under what is called the "non-notification" plan, the borrower collects his own accounts as usual, turning the check or other remittance over to the credit company. The lending company obtains its funds by borrowing from its own banks. Under the "notification" plan debtors are notified of the assignment and payment is made direct to the finance corporation.

The effect of obtaining money in this way is to obtain, thru an intermediary, credit which might not be

obtainable from the bank direct. Is this desirable? The answer lies partly with the purpose of the loan and partly with regard to the position of creditors of the borrower. If more credit is wanted to expand operations in times of business activity and banks are unwilling to make further advances, there is at least an open question as to whether the limit of desirable expansion has not been reached.

A new concern without a well established line of bank credit can probably use the services of the credit company to advantage. Borrowing to discount bills payable is another practice about which there is nothing inherently unsound. A well managed credit company will inquire into the character of the accounts pledged and it will only accept a certain percentage of accounts where the credit standing of the customer is unsatisfactory. The company will also inquire into the use to which funds are to be put, and its advances are made to provide working capital as distinguished from fixed assets.

From the standpoint of creditors of the borrowing concern objection lies not so much against the legitimate activities of the credit companies but against the abuses to which borrowing of this sort may be subjected and the secrecy of the transactions. A business which assigns its accounts is transferring part of the assets to which creditors look when extending accommodation. If the loan obtained is devoted to the reduction of other liabilities, the position of the borrower will be substantially the same. It is

urged, however, that creditors should properly be informed of such assignments. The borrowing may be a considerable extension of the borrowing concern's credit and may have some effect upon the conduct of general creditors. The National Association of Credit Men advocates the adoption of statutes which shall make compulsory the registration of assignments of accounts when the account is over fifteen days old. For houses which customarily assign their accounts in due course before fifteen days, protection would be provided by requiring notice to be given to creditors or a registration made.

9. *Where book accounts are advantageous.*— While every objection that has been noted against the book account as a method of selling on credit is valid, it is not to be universally condemned. There are many cases where it is not only the most convenient but the best means of handling and recording credit sales. One of these is obviously the retailer.

Altho some attempts have been made to introduce the trade acceptance into different forms of retail activity, on the whole the open book account is the best method for handling sales to individual customers. In the case of department stores, grocers, dealers in staples such as meat and milk and other retailers, the individual sales are of such frequency and in such small amounts that any method other than the open book account would flood the business machinery of the retailer and introduce an unnecessary inconvenience to the consumer. In the case of the large de-

partment store, its credit machinery is, or should be ample to guard it against getting many accounts on its books that are unsound or that are likely to prove slow pay. Some proportion of such accounts is, of course, unavoidable, but with houses selling in small amounts and at frequent intervals to individual buyers, the chief concern is building up a clientele of persons who patronize the place both for the excellence of its goods and for the facilities which are offered for their purchase. Where the individual accounts are small, too, the customer who takes too long a time for payment or who acts in other ways to embarrass the selling house, can not cause so great a degree of embarrassment as to affect vitally the house's financial condition.

Aside from the retailer there are other lines where the open book account is usually more satisfactory than sales on credit documents. Some of these classes of business may be outlined as follows:

A. *Where the capital represented by merchandise sold is not large.*—There are some lines of business where the actual physical goods sold form only a small part of the contract that the selling house enters into. The gist of the contract may lie largely in the services which the seller is going to render. In the case of a business selling only goods, a book account sale means loaning so much of its capital goods for the credit period. If this feature is not present, one objection to the use of the book account is removed and if some other considerations are not present, there

is no logical objection to sales by this means of credit.

B. *"Non-repeaters."*—Some lines of business are engaged in selling a product which is of such a nature that once the buyer has taken it, he is supplied for an indefinite time and there is no likelihood of his being again a prospect for the same product. In such a line of business, the question of the buyer's ability to take the product can arise only once. Whether on the open account or trade acceptance basis, credit standing must be thoroughly investigated. While the collecting and financing advantages of the trade acceptance apply, its use or the use of any other credit instrument would not necessarily cut down the proportion of bad or delinquent accounts.

C. *Contract sales.*—It has been seen that the open book account may give rise to disputes between buyer and seller that can only be settled thru litigation. In many lines, however, while the buyer's written acceptance or note is not taken, the sale is made upon a written contract. Such a contract embodies within itself all of the terms and conditions of the sale, since a written contract is not subject to variation by oral evidence. So far as "sewing up" the buyer is concerned, then, a written contract is as effective a means as any other. The case of the carpenter or plumber who makes repairs for the landlord is an instance. When such a contract is reduced to writing, the contractor has an instrument that precludes the raising of any questions except that of the quality of the work.

D. *Specialties.*—In some lines there may be diplomatic reasons for preserving the book account even tho otherwise it is not desirable. Such a line is that of a specialty where a high-class body of salesmen must not only sell the buyer but educate him frequently to the point where the sale is possible. Here is another phase of the credit man's cooperation with the sales department. Any system of granting credit that would interfere with the effectiveness of the men in the field thru making it necessary not only to sell the buyer on the worth of the product but to sell him on the means of paying for the product constitutes a handicap that should not be imposed on the salesman.

10. *Evolution of credit methods.*—It is easier to pick flaws in an existing system than it is to change the commercial practice of decades. An increased use of the trade acceptance must come as a gradual growth as business houses here and there become convinced of its advantages, or, being convinced, determine that the time is ripe for introducing the practice among their customers. In 1920 an investigation showed that there were 20,000 business houses in the United States using the trade acceptance. This is an excellent showing for a custom that was practically unknown ten years previously. While no survey of a similar nature has been made since that year, it was estimated that in 1928 the number of users had increased about one half over 1920. The number of concerns using the open book account was naturally much greater. Some lines, as indicated above, will

always find the open book account the simplest and most satisfactory method of doing business. In the early days of the trade acceptance friends of the movement were apt to make the mistake of claiming too much for it. What is needed is not a hot house growth of the practice but a steady progress in education and in its adoption on its merits. The trade acceptance is not a panacea or cure-all for all credit ills. It has merits that may commend it in time to the general use of a large part of the mercantile community.

REVIEW

From the credit grantor's standpoint wherein does the practice of selling on open book account put him at a disadvantage?

How are open book accounts used for the purpose of raising money?

What commercial abuses have grown out of the present practice of doing business on open account?

What safeguards are taken to prevent the practice of frauds in assignment of accounts?

What are the advantages of the open account system?

CHAPTER III

DOCUMENTARY CREDIT

1. *The forms of documentary credit.*—In the preceding chapter it was brought out that a sale on open account, may be only an implied promise on the part of the buyer to pay for the goods sold. This chapter will deal with forms of sales on credit where the promise of the buyer is not implied but is expressed thru the medium of a written instrument. Such a written instrument may either be a promissory note made by the buyer, or a draft or trade acceptance drawn by the seller. Points of similarity between each of these forms of written obligation will be noted. It is to be borne in mind thruout the discussion, however, that a note or acceptance is nothing more than a written promise to pay. It does not, like a mortgage, set aside any part of the debtor's goods as security for the payment.

Since the note or trade acceptance is only a written promise to pay, it is to be emphasized again that the chief consideration is always the intrinsic worth of the buyer's promise. Like a sale on a book account, the promise is good in proportion to the willingness, ability and worth of the debtor. A bad written promise is no better than a bad verbal promise. The written

obligations of the debtor, however, have certain manifold advantages to the seller that are coming to be recognized as of very great importance. Consideration will be given to the legal effect of such instruments and to their economic effect—the manner in which the two-edged sword which the buyer holds over the seller in the case of an open book account is thus deprived of one of its edges.

2. *The promissory note.*—A promissory note is nothing more than the written promise of the buyer to pay the seller the amount of the bill at a certain specified time. A common form of note is as follows:

\$200 Cincinnati, Ohio, Jan. 8, 19—.

Thirty days after date I promise to pay to the order of H. R. Smith & Company Two Hundred Dollars at the First National Bank of Cincinnati. Value received.

WILLIAM H. JONES.

There are certain essentials which a good promissory note must possess. In the first place, it must contain an absolute promise. In this connection, an acknowledgment that a debt is due is a very different thing from a promissory note. An "I.O.U." is an admission that a debt is owed, but it is not a promise to pay it. Similarly, such phrasing as "Owe H. R. Smith two hundred dollars, value received," does not, of itself, help create a new instrument whereby the person signing it agrees to pay such a debt. The first consideration to be looked to in a note, then, is whether the promise to pay is absolute and unconditional. If it merely reflects and acknowledges the

justness of an obligation already incurred, it is not a promissory note.

The question may sometimes arise as to whether or not a note is unconditional. A note made payable "two months after goods are sold" would not be good. The goods might never be sold by the buyer. In the same way notes made payable a certain time after the arrival of a ship in port would not be negotiable for the same reason. The same indefiniteness may arise when a note is made payable out of certain funds. If the buyer promises to pay out of funds realized from the sale of certain goods, or out of the proceeds received from certain other business in which he is engaged, his note is again open to question for there may be no proceeds arising from the sources indicated. Not only must there be a promise, but the promise must be unconditional. One class of notes has come up for some question in the courts, namely, where notes are given for instalment payments but the condition is made that in the event of failure to meet any instalment, the entire series of notes will thereupon become due and payable. The validity and negotiability of notes of this class have been established by the courts and such a provision in instalment notes does not affect in any way their validity.

Just as the promise must be certain and unconditional, the person to whom the note is payable must be indicated clearly and the amount of money to be paid must be certain. A promise to pay in goods is not a good negotiable instrument, for the value of

the goods may fluctuate. A proviso that a note is to be paid with interest or at the current exchange, however, does not affect its negotiability, since both of these are elements that may readily be determined and measured in terms of money.

3. *Indorsement.*—It may sometimes happen that the note is indorsed by some person other than the buyer. Such a practice is not usual in commercial transactions and usually it would only occur when it was necessary to fortify the buyer's credit with that of some other more responsible party. When such an indorsement is given, the indorser lends his name and credit to the maker of the note. The effect of such an accommodation indorsement may be briefly referred to. It is a general rule that consideration is essential to a valid contract. Where a person lends his name on a note and receives no consideration, it may be asked how he can be held liable if the maker of the note fails to meet it. This is worked out thru the doctrine of estoppel. Once a man has placed his name on a negotiable instrument that may pass into the hands of innocent third parties, he is absolutely liable to make good the promise of the maker of the note whether the third parties have knowledge of the fact that he is only an accommodation indorser or not. He has made the promise of the debtor his own promise. Having done this, the courts will hold that he is precluded from setting up as a defense on the note the fact that it was not his own obligation and that he received no consideration for lending his name.

An accommodation indorsement means full responsibility to any subsequent holder of the note.

4. *Tangible evidence of indebtedness.*—The note, being a written promise of the buyer, is a tangible evidence of his indebtedness. This evidence being contained in a single instrument, that instrument is negotiable (that is, it may pass from hand to hand) in much the same manner that a note put out by a bank in one town passes from hand to hand among the people in widely scattered parts of the country. The difference is that whereas the bank note passes from hand to hand merely by delivery, the note of an individual passes by indorsement.

Once in possession of a note, the seller has an instrument that he may negotiate. By placing his indorsement upon it, he may discount it at the bank or he may transfer it to other parties who are willing to accept it in lieu of cash. Such third parties are those who are acquainted with the credit and responsibility of the respective parties to the note. While the note is not used widely in mercantile transactions, it has a definite value to the seller when it is obtained either in the usual course of trade or in the course of some unusual transaction. Since it may be negotiated, the seller has it within his power to raise money on the sale thru negotiating the note if it should become necessary for him to do so. A note made by a responsible party places it within the power of the seller to realize cash for his transactions without waiting for the buyer to pay.

5. *Action on notes.*—If it becomes necessary to resort to legal processes for the collection of the bill, a note is a far better basis for suit than a book account. In the note illustrated on page 32, the phrase "value received" appears. The effect of this is to stop the signer of a note from disputing the fact that he received consideration for its issue. Once the note has been made and delivered, questions regarding the actual receipt of the goods are subordinated. When the seller brings action on the note, there are only two things that he is required to prove in order to obtain judgment unless the buyer introduces some defense by way of offset to defend the claim. These matters of proof are (1) the genuineness of the maker's signature and (2) the fact that the note was presented for payment and was not honored. The same matters of proof are also required against indorsers. In this connection, it may be observed that the note of an infant (i. e. one under twenty-one years of age) is the same as his contract—it is good unless he sets up the claim of infancy when action is brought on the note. Accordingly the note of an infant is not of itself void but he may interpose that defense if he wishes to.

6. *Acceptances.*—In 1916 the amount of business financed thru acceptances was almost negligible. In 1928 the volume of bankers' acceptances alone reached a total well over $1,000,000,000. The growth in the use of acceptances and the widespread advocacy of their use merits an inquiry into the nature of the

instruments and the reasons for their increase in popularity.

At its inception an acceptance is in the form of a draft—an order drawn by one person upon a bank or another person, directing the bank or individual to pay its stated amount either to the drawer or to some third person. The mere drawing of such an order has no effect, however, until it is acted upon by the drawee—the bank or person upon whom it is drawn. If the drawee agrees to honor the draft or "accepts" it, the instrument then becomes valid commercial paper.

When the draft is drawn upon some bank, it becomes, when honored, a bank acceptance. When the drawee is a commercial house or an individual it is a trade acceptance.

7. *Bank acceptances.*—Probably seventy-five per cent of bank acceptances are used in connection with foreign trade. X in New York sells goods to a foreign buyer on ninety days time after the arrival of the goods. The shipment may be in transit for thirty days. X would have to wait four months before receiving payment and if many transactions of this sort were carried on, a considerable part of his working capital would be tied up. To avoid this, the foreign buyer arranges thru his own bank for an acceptance credit with a New York bank. When X is advised that this has been done, he draws a four months draft upon the New York bank and attaches to the draft the documents covering the shipment. The New York bank accepts the draft and forwards the docu-

ments to its foreign correspondent. The acceptance is given to X who may discount it or sell it in the open market. In this way X obtains his money immediately while the buyer has the usual credit term in which to pay. The bank's loan of its credit carries the transaction.

If X, in New York is buying from abroad, he obtains from his New York bank a letter of credit which is forwarded by mail or communicated by cable to the foreign seller. The seller upon authority of the letter of credit then ships the goods, making the bill of lading to the order of the New York bank which has issued the credit. He then draws a draft upon the New York bank payable to his own order or that of his bank. This draft with shipping documents attached is then sold to his own bank or some similar institution having a New York correspondent. The draft is then forwarded thru the foreign bank's correspondent to the New York bank for acceptance. X has provided the foreign seller with the means to raise money on the transaction immediately while he has until the maturity of the draft to meet it in New York.

In financing a domestic transaction by means of a bank acceptance the draft may be drawn against shipping documents covering title to the goods or against warehouse receipts. In the former case the procedure is similar to the first transaction described. In the case of a bank acceptance against a warehouse receipt, known as a commercial credit bill, the draft is drawn

directly on the bank by the party having possession of the receipt.

8. *Nature and form of the trade acceptance.*—As we have already seen, the trade acceptance is nothing more nor less than a draft drawn by the seller upon the buyer to the seller's own order, with the additional feature that the face of the draft contains the statement that the obligation for which the instrument is drawn arises out of a mercantile transaction. A typical form of the trade acceptance is given on page 40.

In a sale on acceptance terms, when Smith sells Brown a bill of goods, he sends attached to the invoice the acceptance instrument. Upon receipt of the invoice, Brown writes his acceptance upon the face of the instrument. The acceptance is then returned to the seller. A note as to how the legal status of the parties is affected will be interesting at this point. Up to the time Brown "accepts" the draft by signing his name on the face of it, the instrument is no more than a piece of paper of no value and creating no liability. Once it has been accepted, however, the acceptance in effect becomes the promissory note of the buyer. This point is brought out in connection with the features of the promissory note heretofore discussed. Consequently, an acceptance, if made contingent upon the happenings of an uncertain event or made payable out of a specific fund or containing other elements of indefiniteness or uncertainty would be open to the same objections that would obtain in the case of the promissory note.

TRADE ACCEPTANCE

No._____ New York, N. Y., _____ 192____ $_____

_____ after _____ pay to the order of OURSELVES

_____ Dollars

The obligation of the acceptor hereof arises out of the purchase of goods from the drawer, maturity being in conformity with original terms of purchase.

To _____

_____

Due _____ 192____

ACCEPTED

DATE 192 (Date Accepted)

PAYABLE AT (Designate bank or place of payment)

LOCATION OF BANK

SIGNATURE (Signature of Acceptor)

Once the acceptance is returned to the seller, he may either discount it at his own bank and so make use at once of the capital represented by the goods he has sold, or else keep the acceptance in much the same way that he would keep a promissory note until maturity.

9. *Summary of advantages to the seller.*—By the possession of the buyer's signed trade acceptance, the seller is placed in a position where he is no longer so largely dependent on the will and circumstances of the debtor. Thru the ability to discount the trade acceptance at his bank, he can at once obtain the money for the goods sold. So he is provided not only with liquid working capital instead of an open account but his general credit condition is considerably strengthened; this is due to the fact that his resources are virtually reinforced by those of the acceptor who has assumed responsibility upon signing the instrument. The trade acceptance, too, is available for discount at its face, assuming, of course, that the seller's credit has been satisfactorily established at the bank. In realizing on open book accounts considerable latitude must be allowed for doubtful accounts, merchandise returns, claims, etc.

Of almost as great importance as the financial advantages that accrue to the seller are those which affect the general conduct of his business. Under the easy-going means of book account credit, it is only possible to approximate the amount of future income from outstanding accounts and the times at which

it will be received. In the case of trade acceptances running for a given term, the seller may look ahead and with a reasonable degree of certainty calculate exactly his income from receivables for several months. The condition of comparative certainty that results can not fail to be of great benefit to any house that has occasion to change from one method of credit granting to another. Then, in the realm of credit itself, the trade acceptance serves a useful purpose.

When a business goes on the acceptance basis, it may be found that there are buyers who will not purchase under these terms. Since the reason for this is in many instances a feeling of uncertainty on the part of the buyer as to whether or not he can meet the obligation on the day fixed, the result is often that weak accounts among a house's customers are brought to light. Those who purchase under the trade acceptance plan will generally be found to be good accounts. As a result, the seller has not only fortified himself financially and provided himself with a more certain means of estimating his business condition in future, but it has aided him to build up a better class of trade, a class where doubtful accounts are reduced to a minimum.

Even with the best class of accounts, it is, of course, inevitable that occasions arise when the acceptance may not be met. But in this case, too, the seller has less to worry about than in the case of an open book account transaction. If he has discounted the acceptance at the bank, the bank acts as his collection

agent. The men in his organization who spend their time, under the open book account system, in writing clever "dunning" letters are released for more important and more constructive work. And altho it is inevitable that cases may arise when the acceptance will not be met at maturity, it is evident that the buyer will use his utmost endeavor that this does not happen, for the buyer has a vital interest in maintaining his credit reputation at the bank and he knows that a failure to meet the acceptance on its due date is a matter that will impair his credit standing.

Should it become necessary for the seller himself to take action on the trade acceptance, he has the same facility of proof that he possesses in the case of a man suing on a promissory note. If he establishes the genuineness of the acceptor's signature and the fact of presentment and non-payment, he has a prima facie case. Since the acceptance states on the face of the instrument that it is given on account of the purchase of goods from the drawer, a number of small litigious questions are swept aside. The correctness of the seller's account is not only indicated in the instrument but admitted by the buyer's acceptance.

The value of the acceptance does not stop at its beneficial effects upon the seller's financial and credit position. It extends even to the main business of merchandising. For one thing, the buyer having admitted by his acceptance the correctness of the seller's bill, a long step toward eradicating the "return

goods" evil is taken. Then, too, the tendency of the dealer's salesman to overload buyers, where such a tendency exists, is cut down in two ways.

With buyers who make use of the trade acceptance, the salesman must consciously or unconsciously be aware of the fact that to sell the buyer more than he can meet at the due date of the trade acceptance is undesirable for himself, for the buyer and for his own house. In the case of buyers concerning whose credit there is any doubt and who do not use the trade acceptance, this will be still more pronounced. Here is a class of doubtful account that by its refusal to use the acceptance indicates its own lack of confidence in the ability to pay in accordance with the terms. In such a case the buyer by his act raises a serious question as to his desirability as a credit risk.

Another merchandising point to which attention generally has not been directed is the fact that the trade acceptance is a direct aid in increasing the rate of turnover. It is a rule of all good merchandising that money for goods or services should be obtained as soon as possible after the transaction has taken place. Meanwhile, a seller must rely upon his bank and mercantile credit for any enlarged operation; this is in itself a limitation. The success of the dealer's operations, then, is gauged by the rapidity of his turnover. Now, with trade acceptances in hand for all his sales, even tho they may be held to maturity, the seller should be able, with definite obligations, capable of conversion into cash in hand,

to enlarge the scope of his operations and so speed up the rate of his turnover thru his enlarged working capital.

10. *Advantages to the buyer.*—Altho the manifold advantages that accrue to the seller have been indicated, the trade acceptance is not the direct antithesis of the book account in transferring all the advantage from the buyer to the seller. There are advantages accruing to the former no less important than those which the seller obtains. One of the foremost of these advantages is that the trade acceptance is an encouragement to careful buying. It has been shown how, with the open book account method, the buyer's enthusiasm may lead him to overstock, or he may do the same thing with an ulterior motive. He has always before him the temptation to buy up to the limit of his credit title, being generally optimistic that he will be able to turn over his large stock in time to honor his obligations. With the trade acceptance another and different kind of limit is established. Instead of buying to the limit of his credit title, the buyer will order only to the amount of his ability to meet his written obligations. His regard for his credit standing at the bank will act as a deterrent in taking large amounts of stock, the acceptances for which he may be obliged to default.

It has been seen that the seller reaps an advantage from the trade acceptance in being able to estimate ahead with reasonable certainty the kinds and the amounts of his future income from his receivables.

This same feature is an advantage to the buyer. He knows ahead of time just what written acceptances he has coming due. With the loose book account, where a man may know he has bills amounting to $1,000 coming due within the next two months, there is always the temptation to use this money in laying in additional stock if he thinks it advantageous, or to employ his receipts in some other way than in preparation for paying off the accounts when they come due. Since the acceptance matures at a definite date and will be presented at his bank, he is impelled to make provision ahead of time for taking care of definite amounts at definite periods and the result cannot fail to be beneficial to his entire business. The presence of "trade acceptances payable" on the buyer's balance sheet is indicative both to seller and to banker that he is pursuing modern business methods, that his obligations are being met promptly and that the obligations he has due are for current mercantile transactions.

As the seller's general condition is improved thru the use of trade acceptances, part of the benefit should accrue to the buyer thru the better terms which the seller is consequently able to offer. Even if this benefit is intangible and no appreciable reduction of prices by the seller is in evidence, the house which uses trade acceptances approaches very nearly the standing of a house which buys for cash.

Then, too, just as the trade acceptance may well aid the seller in increasing his rate of turnover, it can

aid the buyer in expanding his volume of business. This may be shown by the case of a house which has before it a transaction presenting attractive opportunities for which the seller requires $5,000, immediately. If the buyer's credit is good, he can of course borrow this amount from his bank, but as he is expected to leave a certain part of the loan on deposit he would have to borrow and pay interest on a larger sum in order to obtain $5,000. Thru the use of the trade acceptance in a transaction of this sort, the buyer in good credit standing should be able to swing the deal for the full amount by giving his negotiable paper.

11. *The bank and the trade acceptance.*—The bank is the good business man's ally. Any change in the credit system that benefits the business man should show a corresponding advantage to the banking system. These advantages are almost self-evident from what has already been brought out. For one thing, in discounting a trade acceptance the bank has two-name paper fortified by the signature both of the acceptor and the seller who discounts it. It is commercial paper of the first class. Then, thru the very nature of the instrument, the bank has the assurance that it has its foundation in an actual business transaction of current date and also that the acceptor of the draft is engaged in business. This makes it extremely likely that the obligation will be met when it matures. The ordinary promissory note gives no indication of its source. The money may

have been borrowed to pay a gambling debt, or for any other reason. The presence in considerable volume of so much good commercial paper provides the banks with an ever-increasing field of business and makes it possible for them to extend more liberal facilities to customers than they could possibly do under the open book account method.

The crowning feature of the trade acceptance from the banker's viewpoint, however, is in the preferential rate of discount it may enjoy with the federal reserve bank. This preferential rate may run about one half of one per cent lower than the rate for ordinary commercial paper. In order to be eligible for rediscount at a federal reserve bank it is necessary that the trade acceptance run for not longer than three months from the time of its acquisition by the Bank in the case of ordinary mercantile transactions and for not longer than six months in paper arising in certain other transactions. A trade acceptance with these stipulated terms of maturity, then, may be rediscounted by the local bank with its Federal Reserve centers at a better rate than other types of commercial paper, and so it ranks near the top, next to bank acceptances, among the business man's negotiable instruments.

A valuable adjunct to the bank is growing up, too, in the formation of discount corporations. The object of these corporations is to provide an open market where prime acceptances may be purchased and discounted. The growth and development of

such houses should, in time, provide an open market thruout the country where prime commercial paper such as the trade acceptance may be sold as readily as merchandise. This will favor a more extended use of these instruments and thus lend elasticity to the country's financial system.

12. *What is a commercial transaction?*—It has been noted that in order to be eligible for passage as a trade acceptance, the instrument must bear upon its face the statement that the obligation arises out of the purchase of goods or out of a commercial transaction. In this connection the question may often be presented of exactly what limits are set to the definition of commercial transactions. The picture is at once presented of actual goods, such as groceries, steel products or other trade staples being bought and sold in the usual channels of commerce. The trade acceptance is not limited, however, solely to undertakings of this sort. A few examples will indicate the latitude that is extended to the meaning of commercial transactions. It has been definitely decided that a trade acceptance drawn by the seller of advertising space on the advertiser and accepted by the latter is a trade acceptance eligible for rediscounting at a federal reserve bank. This places advertising space definitely in the category with "goods, wares, merchandise and agricultural products." The proviso that is attached to this ruling is that the advertising must be for the promotion or facilitating of production, manufacture, distribution or sale of

goods. However, a trade acceptance drawn by a publisher to cover the cost of advertising a house for sale is not eligible for rediscount. On the other hand if an advertisement is placed for the sale of pianos, it stimulates the sales of goods and an acceptance drawn in payment could be rediscounted.

Another example of an eligible trade acceptance is where the transaction involves the sale of electrical appliances and their installation by the vendor. Even tho the trade acceptance is drawn for an amount including both the installation and the appliance itself, it has been held that this is discountable within the meaning of the act. The same ruling was made in the case of an acceptance drawn upon a gas distributing company by a gas producing company. On the other hand, an instrument drawn for the amount of an insurance premium, it has been ruled, does not arise out of a transaction involving the sale of goods, wares or merchandise and so would not be eligible for rediscount.

13. *Preserving the discount.*—In changing over from long-established credit customs, the question may readily come up as to whether the discount can be retained if the trade acceptance is put into use. There are several ways in which this may be provided for. For instance, the trade acceptance may provide for a discount if it is paid at maturity. Such an acceptance would be drawn for the amount of the order, less the customary trade discount, and contain a proviso that if not paid at maturity, a greater

amount, the gross value of the sale, shall be the amount then due and owing to the seller. The same result is also reached thru using an acceptance for the gross amount of the sale but providing in the body of the instrument that if it is paid at maturity, the acceptor is entitled to the benefit of a discount of five per cent on the amount of the invoices.

Houses which sell for cash or the bulk of whose business is on 30-days' time would hardly be concerned with this question and, in fact, the cash-sale houses will not be interested greatly in the trade acceptance. In the case of houses which sell on longer time than 30 days, however, credit terms may well be introduced offering exceptional accommodations to those who take advantage of the trade acceptance. This can be done because of the preferential discount rate commanded by the acceptances. An example of such an arrangement would be a sale on the following terms: "Three per cent, 10 days—two per cent, 30 days—one per cent, 60 days trade acceptance; 60 days net open book account." Thru such an arrangement, not only is the buyer induced to take advantage of the trade acceptance privilege, but this inducement gains strength thru the offering of exceptional discount privileges. An example of the body of trade acceptance drawn to take care of the discount feature is given below:

_____after date pay to the order of ourselves
_____dollars, or if not paid until after due date
_____dollars, with interest from said due

date at 6 per cent per annum. This acceptance is drawn to cover invoices of ——————for goods furnished by the drawer to the acceptor, and if paid at date of maturity gives the acceptor the benefit of a discount of five per cent. (5%) or $——————on the amount of such invoices.

14. *Other trade acceptance features.*—In some lines of business sales are made at frequent intervals and in small amounts. Where this is the case and it is not found desirable to send a trade acceptance with each invoice, there is no objection to the practice of sending an acceptance for the total amount of the purchases with the monthly statement. Such an instrument possesses the necessary feature of being drawn to cover transactions involving the sale of goods, and by lumping all sales in one invoice, the burden of covering numerous small transactions in this way is avoided.

There is the case, too, of the buyer who may wish to pay his accounts some time before the maturity of the trade acceptance. Where this is the case, arrangements can easily be made either with the seller if the acceptance still remains in his hands, or with the bank if it has been presented for discount. The matter necessary for observance in this instance would be that the buyer give sufficient notice to the seller or to the bank of his intention to prepay.

Cases have also arisen where an acceptance is drawn for the net amount of a bill and payment is not made at maturity. Say a sale is made for $200 gross with a discount for three per cent. If the ac-

ceptance is made for $194, even tho not paid at maturity, the seller may recover both the amount of the acceptance and the remaining $6, which may be included as an open book account item. Accordingly, the seller runs no risk of losing the discount even tho the instrument be drawn for the net rather than the gross amount of the sale.

15. *When the acceptance is not paid.*—Supposing a trade acceptance is not paid at maturity—what position is the seller in? Of course he has an action at law on the instrument itself. It is assumed, however, that this is the last thing he wishes to do and that, desiring to retain the buyer as a permanent customer and wishing to aid him over the temporary financial embarrassment that has made it impossible to meet this particular acceptance, he is casting about for means of preserving his account in the same liquid form. It has been suggested that another acceptance could be given by the buyer in renewal of the one that has been defaulted but this is entirely contrary to the spirit of such instruments. They should at all times preserve their identity unqualifiedly as documents representing current transactions.

The best means of extending further time to the buyer and at the same time keeping the seller's account in liquid form would be to induce the buyer to give his note at the current rate of interest. The extension of time would be the consideration for the note and in addition the seller has the two-fold advantage of having a negotiable instrument in his

possession and of drawing interest for the further use of his capital represented in the goods sold. Some acceptances are so worded as to provide on their face that interest at the rate of six per cent per annum is to run if not paid at maturity. The best practice, however, is to substitute for the acceptance a promissory note of the buyer if this can be arranged.

16. *Retailers and the trade acceptance.*—While the trade acceptance is not an ideal credit instrument for retailers, as has been pointed out, it is possible that there may be instances where it will be found advisable to introduce it. Such a case might arise in businesses where the articles retailed are large and have considerable relative value as in the case of ranges, pianos, and other similar articles. Where a business of this sort not being on a cash basis might wish to introduce the trade acceptance, it might be done thru an arrangement whereby the buyer would pay a certain amount, say 33 per cent cash at the time of the sale and then execute one trade acceptance for 33 per cent more payable in 30 days and another for the balance payable in 60 days. Such a practice is in effect in some parts of the country and the result has been satisfactory. A class of business such as this furnishes one exception to the general consideration that the open account provides the least cumbersome method of doing business for retailers.

17. *Introducing the trade acceptance.*—However desirable the trade acceptance may be, it is inevitable that in introducing it in lines where open book credit has long been in vogue, a considerable educational campaign will be necessary. The almost universal custom of lines where this has been done has been to send out a letter with the trade acceptance, explaining concisely what it is and why the selling house wishes to introduce it. Once a campaign to introduce the trade acceptance has been launched upon, however, the selling effort should not be half-hearted. The selling house must make it plainly evident to all its customers that it has gone on the trade acceptance basis; that buyers who use the trade acceptance will usually be regarded as in a class by themselves as a credit risk and that failure to take advantage of it will *per se* redound as a rule somewhat to the disadvantage of the credit title of the house which does not use it. Variations on this may be notes which simply take it for granted that the advantages of the trade acceptance are known and that the acceptance by the buyer is regarded as a matter of course.

A wholesale house in New York sends out trade acceptances in the following form. Attached to the acceptance itself and capable of being detached thru a perforated line is a memorandum of the same size giving the following explanation of why the acceptance is forwarded and containing the suggestion that its use is regarded as a matter of course.

DETACH AFTER SIGNING

A TRADE ACCEPTANCE

Is an acknowledgment of a debt by the buyer in favor of the seller, for merchandise that the seller had placed in the hands of the buyer with which to pay this debt. The buyer agrees to pay at a certain date, at his own Bank, to the seller, the amount of this certain indebtedness by writing across the Face thereof, "Accepted," the date, and name of his own bank and his signature thereon.

This varies from the open book account method only in giving the debt a negotiable value.

According to a FEDERAL BANK GOVERNOR'S OPINION, the *signing of an Acceptance increases the financial standing of the giver*, because it shows prompt paying methods.

Kindly sign attached Acceptance, then forward to W. & J. Sloane, Fifth Ave. and 47th St., New York.

18. *Future of trade acceptance.*—An old legal maxim runs substantially this way: "When the reason for the law ceases, the law itself is silent." The trade acceptance and the modern credit system present an analogy in the commercial world. The primary reason for cash discounts has long passed. Credit is on a sound basis. The Federal Reserve Act will tend to prevent excessive tightness in the future. With the entrance of the United States into world citizenship and the abandonment of our provincial position of isolation from the world channels of trade, it is becoming increasingly desirable to adopt the trade systems and methods similar to those in use among other great commercial nations. Especially is this desirable with an instrument that contains within itself the advantages to buyer and seller and

to the country's banking and financial structure that the trade acceptance carries.

REVIEW

What do you understand by "documentary" credit as distinguished from book credit?

What are the chief distinctions between notes, drafts and acceptances?

Summarize the advantage of the trade acceptance from the seller's point of view. From the buyer's viewpoint also.

What is the bank's function in the handling of trade acceptances?

Discuss the trade acceptance as applied to retail trade.

CHAPTER IV

GRANTING CREDIT TO THE CONSUMER

1. *Credits, retail and wholesale.*—Between the credit activities of a retail house and those of a jobber, wholesaler or manufacturing concern there is a marked distinction altho they have the same objects. Wholly different policies must be employed to meet the needs of two radically different kinds of patronage.

The retailer who sells on credit sees his stock of clothing, food or furniture passing over his counter to immediate use or consumption, while the wholesaler sends his goods to the retailer's shelves to be resold at a profit. The retailer's opening of new accounts and handling of those outstanding is based on the principle that he can afford to sell only to customers who have the ability to pay, those who have shown the willingness to pay, and those who are ready to cooperate reasonably in keeping to the terms for payment agreed upon because they value the privilege extended to them.

The retail credit man always has one object in view, an increase in sales with a minimum of losses. He wants to open as many accounts as possible, but to open them on a discreet basis, and he understands that

he must watch them with such care that his percentage of losses will not rise. The retailer realizes that his credit department's worth to the house is directly in proportion to the volume of the open accounts on his books. If open accounts run to the amount of a million dollars, the credit department is earning just twice as much for the house as if they were five hundred thousand, always providing the percentage of losses does not increase.

2. *Why charge accounts are allowed.*—Retail merchants allow charge accounts for one reason only, that by so doing they may make themselves more successful. As long as a credit system is a convenience to the customer—so much so that it increases the volume of business and likewise the turnover—it will pay for its own cost; and like advertising or window display will take its place as a good investment in store service.

Every retailer knows that it is the repeat business which pays the best. Those customers who buy for cash do so wherever they may be and often in response to curiosity or interest aroused by the advertisement of startling bargains. The credit customer is likely to give her entire trade in a given line to one store. She comes to know the clerks and the management and the result is a mutual advantage for both customer and store. For much the same reasons, credit sales average larger per person.

This is the natural result of the satisfaction of buying where one is known and where long acquaintance has verified the store's reputation for quality and

service. The straightforward, square-dealing merchant knows that he gives value received, and is assured that the satisfaction of his customers will lead them to treat him squarely in return—to pay for goods as agreed. Charge customers make relatively few complaints. A large percentage of such complaints results from misunderstandings, and the customer who has the confidence bred of years of trading is sure to be more patient and open minded than another not so well acquainted.

3. *Limits upon credit.*—In fixing limitations on the amount of credit and on the length of time for which it is granted, a manufacturer or dealer will be governed by three main considerations:

(1) What kind of man is the applicant? His character.
(2) How is he conducting himself and his business? His capacity.
(3) What has he in the business he is conducting? His capital.

The controlling factor in granting all credit, as indicated in these three phases is confidence in the applicant's ability and willingness to pay his bill when it falls due. Character is the essential of primary importance, because men lacking character cannot be trusted no matter how skilled they are as money makers or how much money they may have made.

When the retailer grants credit to the consumer he must, no less than the wholesaler or the manufacturer, give primary consideration to the first of these basal questions—the buyer's character. It is the foun-

dation of all "personal" credit to the consumer, and it is at the same time one of the chief matters of inquiry in the granting of "mercantile" credit extended by one merchant to another when goods are purchased on time for resale.

In a wholesale or manufacturing business, credits are matters of course. The retailer requires credit when he makes a purchase so that he may have enough time to sell the goods to the consumer, enabling him to repay the jobbers or the manufacturers who have extended him credit. The retailer in turn grants credit accommodation to his consumer customers when such credit will help his business by increasing the volume of the customers' purchases.

The customer of a retail store cannot be judged, however, solely by the amount of money he possesses, for the majority of consumers are not in business for themselves but live on salaries or wages which indicate a certain earning capacity. They have nothing to offer comparable to "liquid capital," so important an item in the retail dealer's statement when he goes to the wholesaler for credit. Nor is "character" considered altogether in the usual sense, for when applied to consumer credit there are certain types of customers who buy large amounts at a good profit to the retailer who might not be considered models of character. Every large city jeweler, department store or specialty shop has many such accounts and finds them profitable. The quality of "character" that is essential in the retail customer is that which will not permit

him to attempt to purchase what he does not expect to be willing or able to pay for at the proper time. This quality might better perhaps be called "cooperation" —his willingness to be bound by the store's rules for buying according to capacity and paying accounts promptly. The degree of promptness in payment is the measure of this cooperation. Capacity to pay promptly or eventually is a prime requisite in retail as in wholesale credits.

4. *Definite house policy.*—The general policy under which the retailer's credit and collection system operates must depend upon an analysis of the store's trading territory, the qualities of goods the dealer can carry to meet the best needs of the neighorhood, the prices his customers will expect to pay, or the amount of store service they will demand.

The factors which help to determine a store's credit policy are (1) the character of the business, (2) its size, (3) its financial status, (4) local conditions.

For example a retail hardware store bases its policies on conditions that would not apply to a retail grocery store because of the differences in the goods offered for sale and in the demand for them. Everyone in the community must eat, and the grocery store is the source from which the universal demand for foodstuffs is ordinarily met. The hardware man, altho no less useful a servant in the community, caters to a less universal patronage. This involves a more seasonable demand and as compared with the customers of the grocer, constitutes a

trade which is largely made up of house owners, who are better off financially. It is the house owner and not the renter who ordinarily buys kitchen ranges, fireless cookers, refrigerators and the like.

In much the same way the small specialty shop would probably have fewer requests for credit accommodation than a big department store. A shoe dealer located in a factory community where most of his customers are paid by the week would have to consider this fact when he came to fix limits of time and amount on individual credit purchasers.

5. *Receiving credit applicants.*—It is often an expensive operation to obtain the first order from a new customer if one considers all the store's efforts to get him to the counter thru publicity, advertising and service. It is necessary to give great care as to how applications for credit shall be handled so that the accounts may be made to grow eventually into profitable ones.

In such cases it is the first time that the customer has dealings with the credit department, perhaps with the store, and first impressions are lasting. It may also be the only occasion that the credit department may have to deal directly with the customer. This is often the case when the credit office is so situated that the department staff does not come in direct contact with visitors to the store. If the opening of the account is handled well, if the customer is put at her ease at once and leaves thoroly satisfied that she has established a useful and convenient relationship with

the store, it helps materially later when the account is to be collected.

6. *Tact in handling applicants.*—Credit men in the larger retail establishments, especially department stores, become very expert in judging feminine human nature, for the majority of shoppers in such stores are women. They have learned to recognize pretenders who like to pose as wealthy and socially prominent when they are not. The credit man knows that many well-to-do gentlewomen dress plainly, but on the other hand many who assume a grand manner have nevertheless a good financial standing. If the applicant appears insulted when asked to answer a few customary questions, the credit man may have reason to suspect that her account is not desirable. Moreover a woman who is either unduly talkative or needlessly uncommunicative makes an equally dubious impression as a credit risk. One who talks too much may be trying to hide something by it, and one who will volunteer nothing at all is at least unfair to the store, for she ought to appreciate that the management is entitled to know something about her before extending credit.

It may be, however, that at the outset a woman will say little because of embarrassment. She probably is not accustomed to business ways, but after the ice is broken she may talk with surprising freedom, because of a sense of relief, because she feels the worst of the ordeal is over.

While a customer seeking credit has no justification

for being offended when asked about his or her financial conditions, yet the tactful credit man will get his information with the fewest questions possible.

As an example of how it is possible to induce a sensitive customer to supply answers to questions without knowing that she is doing so, the following conversation between a credit man and a woman who gave evidence of being high strung is interesting.

"I would like to open a charge account here," was all the information volunteered by the applicant.

"Very well," replied the credit man. "Just let me jot down your name." She said her name was Mrs. James L. Flint.

"That's not the Flint down at the City Hall, is it?" inquired the credit man in friendly fashion, as if his only object were the interest in discovering a former acquaintance.

"Oh, no," she replied, "my husband works for the Public Service Company. He's been there for the last six years."

"That's right. Isn't he in the accounting office?"

"No, he's assistant in the contract department."

"Now, if you'll give me your street address," the credit man went on, reaching for his pen, "I'll put it down here on our record."

"We live in West Hamilton Place," was the reply.

"West Hamilton Place. Well, that's a nice little street. A friend of mine nearly bought a house out there last spring. By the way, Mrs. Flint, what's property worth out there now?"

"Well, we paid eleven hundred for our lot just before we built, but that was some time ago. When we reduced the mortgage recently the man told us the values there had advanced a good deal."

"I suppose you know my old friend George Hartford, the grocer?"

"Yes, we usually buy at Adams, though."

"Well, that's a good store, too."

Now, without any formality and without the customer's realizing that she had told anything about her financial standing, the credit man had learned a number of facts.

He knows where her husband is employed and the nature of his work, from which he can guess pretty accurately the amount of his salary. He knows that they live in a good neighborhood and own their own home. Moreover he knows where they buy groceries and can easily find out from the grocer whether they pay promptly. He can use the telephone and the city directory to confirm the other things she has told him. He not only procured the facts wanted without giving offence, but the customer was pleased at the chatty and human way the store had dealt with her.

That an extensive knowledge of human nature, and the ability to use tact and diplomacy in handling applicants are essential to the credit interviewer is quite apparent. Obviously, it would not do to handle all customers in the same way. Many, being more familiar with business customs, expect the matter to be handled with more formality and are quite prepared to answer questions. In most cases the applicant for credit fills out a card which calls for information on certain definite points and answers a few additional questions.

The following application, used by the Retail Merchant's Bureau of a middle western city, will serve to illustrate the kind of form that is growing quite gen-

erally in use now among organizations of Retail Merchants.

APPLICATION FOR CREDIT

Full Name .....
Wife's Name .....
Present Address .....
Former Address .....
Occupation.....Where Employed .....
If Newcomer Where From .....
Street and Number .....
Own Home or Rent .....Landlord .....
Nearest Relative .....
Address .....

GIVE NAMES OF MERCHANTS TO WHOM YOU CAN REFER

Name .....
Address .....
Name .....
Address .....
Name .....
Address .....

In applying for a charge account I agree to pay my bills on or before the tenth of the month following date of purchase, or, in payments as follows:

.....
Date .....Signed .....

7. *Questions to be asked.*—While it is possible to schedule the exact information that it is necessary to secure for reasonable safety, it is not always desirable to push the questioning until all such information is obtained. There is plenty of room for the exercise

of judgment. The points which should be covered, if possible, are here listed.

Correct name, including first name and middle initial and name of husband or wife if applicant is married.

Address and previous address, if the applicant has moved recently. This would apply equally whether the applicant has resided in the city for some time or is a new resident.

Occupation of husband or self, and length of time employed. If only for a short time, previous position and length of time employed.

Obtain names of firms with whom customer had accounts where the applicant formerly resided if the applicant has recently come to the city.

If the applicant is single, obtain the father's full name and occupation as well.

Ordinarily the credit man should be given at least twenty-four hours before giving his decision, in order that an investigation may be made. This much time is necessary in justice to the customer and to the house.

8. *Impressing the terms of credit.*—Before the interview is concluded the customer should be made to understand the precise terms upon which credit is granted. This is the best insurance against future misunderstandings. A limit should be placed on all accounts because of the fact that it gives the quickest warning of approach to the danger point in the use of the account. It is well to get from the customer a statement of the highest probable amount that the account will reach in any one month.

In the case of young people who have no definite idea what this amount will be, it is best to place a limit

and arrange for them to visit the credit department if at any time later they wish to purchase in excess of the amount that has been set. In some cases it is desirable to tell the customer definitely what the limit will be. In most cases, however, it would be a mistake to do so.

Experience indicates that an applicant will answer questions readily if they are asked courteously and definitely and as tho the credit man not only expects to receive the answer but is quite secure in his right to the information.

Some merchants have used with success regular application forms to be filled out in duplicate by the applicant for credit. One copy in such cases is sent the local credit association or rating bureau. Such applications provide spaces for all the information that was suggested in the questions to be asked of the applicant and provide the fullest possible basis for easy investigations.

9. *Personal references.*—Persons whose names are given as references by the applicant at the time of the interview, while not always the most dependable source of credit information, are nevertheless useful for further verification of impressions gained from other sources. Naturally no applicant will name as a reference a person who is other than friendly, and who cannot be relied upon to give a favorable report.

References to business houses, by whom the applicant may have been employed or with whom he has had business dealings, offer a stronger and a more

accurate, because a more impersonal line on his reliability and paying habits. While there may still be a tendency on the part of firms who are named as references to "give a good character" to all employes such requests for information usually find their way to the Credit Department of the employing concern where such information is given frankly, stating facts briefly and candidly. Such exchanges of credit courtesies have been helpful later in getting action in cases where customers so reported have delayed payments. Since those who are given as references are not in any way responsible for the applicant's obligations the only value of a reference of any kind will be the help it may give to an accurate determination of the applicant's earning capacity and his general reliability.

10. *Verifying the facts.*—Immediately following the interview in which the applicant has given the information needed by the credit office as a basis for extending credit, the work of verifying the facts or getting further information begins.

The first step in such cases is to call up the local retail credit interchange bureau, if one is available, or call for the service of a local credit reporting agency if the applicant or her husband is in business. The telephone offers the readiest medium for securing the information quickly from landlord, from bank, or from employer, any one of whom has been named as a reference, altho it is often desirable to supplement such inquiries by personal calls on all those mentioned in the applicant's statement.

When the investigation is completed the credit office records should show what salary the applicant is receiving, his reputation for paying his debts, based on absolute record of purchases and payments, his personal habits, his reliability in positions he has held, what rent he pays, whether he owns his house free of debt or whether it is only partly paid for, as well as his sources of income, if any, outside his regular salary or wage.

11. *Classification of accounts.*—The real work of the credit man is not so much in opening accounts as in keeping in close touch with them after they are started and taking every means to watch for changes in their status that will in any way retard prompt collections. As the surest measure of prevention against loss thru budding delinquency in payment of accounts the credit office makes it its business to classify all accounts as definitely as possible and then to watch each group. It is not enough simply to classify customers as honest or dishonest or as prompt pay and slow pay. It is essential to work out a classification which will group accounts according to their degrees of promptness or slowness and extend the classification to include the "tricky," the careless, the indifferent or the downright, hopelessly "dead beat." The chief value of such a classification of accounts lies in the readiness with which the credit office may decide when to "shut down" or refuse further accommodations.

Undoubtedly the greatest loss from uncollectable

accounts is due to delay, failure to take prompt or proper steps to collect as soon as the account slips into the past due classification. Nearly all slow-paying customers intend, when the debt is contracted, to pay it, but limited means and numerous wants combine to make it difficult for them to make ends meet. They cannot pay all their obligations at the same time; therefore they try to pay a little here and a little there, on the claims that are most vigorously brought to their attention. Close classification of accounts then, with prompt and accurate reclassification from week to week or month to month, is the best possible basis for preventing the growth of the habit of delinquency in good but careless customers.

12. *Credit limits for individuals and groups.*—Carrying the principle of classifications of accounts further, many stores rate certain classes in groups of accounts somewhat as follows, in accordance with the results of credit investigations:

1. Employe's accounts.
2. Temporary or "accommodation" accounts.
3. $25 accounts.
4. $50 accounts.
5. $100 accounts.
6. $500 accounts.
7. Unlimited accounts.

Instead of using such a method of ratings some stores use a system of code symbols to designate the rating of each account. Instructions as to the limit fixed in such cases are given verbally to the store's

authorizers and this does away with any printed list of fixed limits.

As already suggested, at the time it is offered every account should be given a definite limit, beyond which in the judgment of the credit office it will be unwise to permit purchases on charge accounts.

With thousands of accounts on the books changing in status daily, it is impossible for the store credit man to keep himself informed of the exact standing of each one. But with a limit placed on each card or bill the bookkeeper or billing clerk can notify the credit man the minute the limit is reached. This limit need not be a fixed line beyond which there is no possibility of advance; it simply means that when a customer's purchases for any month have reached this limit, further sales must be submitted to the credit man for approval. It serves as a warning by which an account is brought up for attention when the danger point is near. The amount of the limit may be changed several times during the same month, depending upon the condition of the customer's account and the kind of purchases he makes.

13. *Service in credit authorization.*—The question of prompt authorization of daily purchases in such a way as to meet the need for reasonable investigation and checking to prevent fraudulent or dangerous buying is a serious problem for the retail merchant. Naturally the store's reputation for service, made up of a great many impressions of all kinds that the purchaser receives more or less unconsciously at its coun-

ters, is strengthened in proportion to the ease with which charge customers may shop.

The unnecessary inconvenience of waiting for authorization of "charge-take" purchases may, unless checked, do a good deal to alienate valuable patronage. Retailers know that the more desirable women customers, for example, are often most easily offended. When the customer feels that she is under suspicion, because of the fussing around entailed by "looking up" an account under a cumbersome store system, the inevitable result is to strengthen a tendency to go elsewhere to buy. This tendency is sure to develop if by making the change she is disposed to believe, justly or not, that her patronage is more highly appreciated by the new dealer.

The first essential to authorizing a "charge-take" purchase is proper identification of the purchaser as the person with whom the store has an open account in good standing, or as some one entitled to buy for such a customer. In most stores the floor man is given authority to authorize such purchases up to a certain limit—say twenty-five dollars. In some stores clerks are permitted to authorize purchases for small accounts, for example, up to ten dollars.

14. *Retail credit as a business builder.*—The test of a successful retail credit and collection policy is that it gets what is due the store and yet keeps its customers. Such a policy involves the knowledge of human nature in general and of the individual credit buyer, combined with the ability to select the method of treat-

ment that will be most effective with a person in his circumstances. An excellent check upon the store's credit service is afforded by the daily contact with old customers who have formed the habit of trading year by year with the house, and whose continued patronage is held thru continued satisfaction and good service. The net showing at the end of the year is a direct reflection of the consistent fairness with which the buying limits of its customers have been watched and the care with which incipient delinquencies have been noted and checked.

No matter how perfect may be a store's service or its merchandise, there is constant need for adding new accounts to replace those who may be removed by death, by the constant moving and changing of population and conditions in a locality and by the losses due to delinquency and non-payment of accounts.

Since the very life of a retail business depends not only upon keeping customers regular in patronage, but prompt and regular in payments as well, it will be seen that not the least important of the credit office functions is to watch the buying history of its accounts with the idea of singling out those which for any reason lapse into inactivity. Realizing that an account which it is worth while to accept in the first place is worth keeping active, and keeping in mind the obvious fact that it may take months of irreproachable service to the customer before an account may be developed into one which will repay handling, it is only common sense on the part of the store's

manager to go out of his way to find out why once good and profitable accounts occasionally become less active.

There are many instances on record where letters written in the right spirit have been sent to a list of inactive customers and have revived many thousand of dollars worth of patronage.

Experience having shown again and again the business building possibilities of a broad credit and collection policy wisely administered, it may be worth while to note how one authority, a former president of the National Retail Grocers' Association, has summed up out of over twenty-five years of successful experience the outlines of such a policy under the following eighteen heads:

1. Know your customer before extending credit.
2. Insist upon references and investigate them before extending credit to strangers.
3. When the prospective customer hesitates to give references, hesitate in taking the order.
4. Explain that it is necessary to know when to expect payment in order to meet your own bills.
5. Show that by paying your own bills promptly in ten days you are able to sell goods more cheaply, and by paying cash you can often pick up bargains which you can pass on to your customers.
6. Send your statements out promptly every week, every two weeks, or every month according to the understanding you have with your customers.
7. Insist upon full payments every month, and request your customer to call, or see her personally, before you grant longer extension of credit.
8. Do not let your customers decide when they want to pay their bills. That's your job.

9. Remember that the possible loss of a few customers who won't pay promptly is offset by the advantages of prompt payment.
10. Don't be satisfied with merely a financial rating on a customer, but learn something of his character and general reputation.
11. Study your customers and don't trust those who leave a bad impression.
12. Have the courage to say "no." Thousands of merchants have lost thousands of dollars because they would not say "no."
13. Never abandon hope of collecting an old account.
14. Try the method of sending statements only to your surest customers. Use one of your clerks and a bicycle for the collection of all other accounts.
15. Personally examine every uncollected account and have a reason for the failure of your customers to pay promptly.
16. Help to eliminate the "dead beat" by giving careful attention to all requests you receive for credit information.
17. Boost your local credit interchange bureau.
18. Make sure your bookkeeping is accurate. Don't let your customers first discover the error.

REVIEW

What benefit does the retail dealer derive from credits to his customers?

What consideration enters into the question of granting credit to consumers?

How does a retail store secure the information necessary to decide whether or not to open a charge account with an applicant?

What measures may be taken to reduce losses on charge accounts to the minimum?

What are the main points of a sound credit and collection policy for retailers?

CHAPTER V

INSTALMENT CREDIT TO CONSUMERS

1. *Instalment selling as a merchandising principle.* —A study of the advertising pages of any popular magazine of national circulation will disclose a surprisingly large variety of commodities which are offered to consumer users on a basis which will permit payments to be made over a period of time. The articles that may be brought directly into the homes of people anywhere in the country on payment of a comparatively small amount paid down and the signing of an agreement to make further payments at regular intervals, range from automobiles, books, pianos and phonographs, down the line thru kitchen cabinets and vacuum cleaners, to the jewelry, clothes and furniture lines with which instalment selling houses have long been associated in the popular mind.

A great many things sold in this way today could never be sold at all, or at any rate not in anything like the present volume, if payment in full were exacted at once, because consumer users who comprise the bulk of the market for them would seldom feel that they were justified in making such a large single expenditure. With the intensive cultivation of the market, particularly for the heavier and more expensive

specialties which lend themselves so well to this kind of a marketing plan, has come a radical change in the former attitude toward instalment buying.

At one time the instalment house, so called, was regarded chiefly in the light of a benefactor of the person of small means who was more or less driven to patronize it by the force of economic necessity. Under the older methods of passing on applications for instalment credit the house took the position of one granting a favor and so permitted itself to ask any question and to dictate any terms. Frequently the house did not consider very carefully the sensibilities of the buyer.

There is now too much competition in this line of business to permit the employment of such sledge-hammer methods. Buying on instalments no longer reflects any discredit on the buyer as was once the case. He is quite as likely as not to have money invested or in a savings account which he does not wish to draw upon. He has a choice of many houses for the purchase of what he wants and consequently he is independent and more sensitive.

2. *Advantages of instalment selling.*—Houses that sell on the instalment plan have the advantage over the retailer in one way; they usually receive a cash payment for part of the invoice and have a contract or mortgage of some kind for the remainder, which protects them against the loss of the goods except in cases of actual fraud. On the other hand, the instalment dealer is at a disadvantage as compared with

the retailer, for he cannot discriminate as to whom he shall trust; he must sell on his announced basis to virtually all who offer themselves and give evidence of a fair stability of income. If he refuses to accept their orders, he not only loses the sale but the customer's entire trade, while the retailer, if he does not think it desirable to extend credit, can often persuade the applicant to pay cash and still keep his patronage. The retailer can without giving serious offense put off granting credit for months until he knows his customer's trustworthiness from personal experience. The instalment house has no alternative; if it refuses credit, it loses business.

3. *Instalment credit to local buyers.*—In granting credit to a new customer the credit man of an instalment house whose patronage is local has the chance to meet the applicant in person and size him up as a credit risk. Even tho he must depend almost entirely on his intuition and experience in judging men, he has two classes of people to face among others: those who are honest and of good intentions, but who overestimate their ability to pay and eventually will fail to pay; and those who never intend to pay and are simply trying to obtain the goods under false pretenses. Such strong safeguards have been placed about the instalment contract, however, that fraud is difficult and dangerous to those who attempt it.

Having the bill of goods ordered and the buyer himself before him, the instalment credit man must decide almost on the spot from his impressions of the

individual and the information he obtains from his direct questioning, whether to approve the sale and allow the credit. In the brief space allowed him he needs extraordinary adroitness to obtain from the customer by indirect methods the information which is necessary to establish the customer's stability and circumstances.

4. *Terms.*—In the old days an instalment dealer would deliver anything in the store on a very moderate first payment and on long terms, such as fifty and sixty months. The war changed all that. Now a larger initial payment is almost always required as an insurance against loss, and shorter terms obtain in all lines that use the instalment method. Ten per cent "down" payment is quite common. In lines like musical instruments the first payments demanded are now considerably larger than formerly. Phonographs and piano sales are made on terms which are now likely to average below fifteen months and thirty months respectively.

5. *Recording contracts.*—Some instalment credit men advocate the practice of recording all contracts whether the amount is large or small. Others record only when the amount is over $50.00. The filing or recording of a contract serves to make a legal record of its existence and protects the house against losses thru attachment by a third party for debt or other causes. The fee for filing in New York State is fifty cents, but altho each fee is small in amount, when multiplied by the thousands of contracts taken such

recording may add a considerable item to the expense of the business.

6. *Mail-order instalment credit.*—Mail order houses, which have grown in size and in numbers during the last few years until their annual volume of sales has reached the hundreds of millions, have been quite commonly supposed to sell for cash only. A credit department functioning in the ordinary way, therefore, seems unnecessary to them. As a matter of fact while they sell for cash, they also sell on credit. If they did not do so they would be automatically shut out from a large volume of profitable business that they now transact—business that really pays better net returns than that gained from many of the cash sales. The fact that a considerable proportion of the country's retail mail order business rests on a credit basis is one of comparatively recent development. It has grown so quietly, and yet so naturally and rapidly that the mail-order people themselves hardly realize its extent.

It is not strange, then, that retailers all over the country should make the mistake of believing that the mail-order houses invariably exact the cash in advance and still urge this as one of the reasons why people should buy of their home stores.

7. *A psychological principle at work.*—This breaking away from the iron-clad cash basis has come about for the simple reason that people will buy more readily for credit than they will for cash. They also buy in greater volume. There is a psychological prin-

ciple involved here. A woman who telephones her order to her grocer will often buy things with little regard for prices and qualities. When she pays cash she automatically becomes more careful in her buying. If she has a charge account at a department store she buys more heavily than if she pays cash. The first of the month with its bills seems a long way off. Every retailer knows that he can sell more goods to customers on credit than if he did a strictly cash business. That is why he is willing to continue to "carry" people and borrow money at the bank to carry on his business. The added volume of business secured usually is sufficient to overcome the disadvantages of the system. The retail mail-order people have proceeded from the same consideration in their development of credit selling by mail and their problem of insuring payment is much simpler than that of the local merchant. Their losses thru dishonest customers are practically nothing.

A man who goes into a hardware store to buy a kitchen range without paying down all the money knows that he must pass muster before the credit man. He will have to open an account. But he can send to the Kalamazoo Stove Company and get the stove without an argument. Probably, an imaginary case too, he would be much more likely to pay the stove company promptly than he would the local dealer. In one case the stove would be bought on open account, and in the other it would be purchased on a definite instalment contract calling for the pay-

ment of certain sums at certain times. People may be slow about paying their home retailers, but usually are careful to meet their contract obligations to concerns out of town.

8. *Things sold on credit by mail.*—Articles that are offered on the instalment plan by mail as well as by regular instalment houses are generally those which are relatively costly. A farmer sending to a mail order house a properly filled out order accompanied by the requisite amount of cash for the first payment can get a piece of farm machinery costing perhaps into the hundreds of dollars. With rare exceptions he could not buy two or three hundred dollars worth of miscellaneous articles on the same terms. Not only does the dealer expect such smaller purchases to be made out of current income without mortgaging the future but he is guided by the consideration that in instalment credit the article sold is always in itself a pledge for the unpaid balances, and it would be cumbersome and inconvenient to have this pledge spread over a variety of articles.

Things like farm tractors, washing machines, talking machines, automobiles or pianos and many more are offered for sale on successive payments. Selling by mail on the instalment plan, when it was started by concerns like the Kalamazoo Stove Company, was regarded by some as pure business idiocy. But in reality it proved to have a most powerful selling appeal. The customer, having sent in his order on a blank form from the catalog and accompanied by the

small amount of cash required as a first payment, receives the coveted article at once. He has the privilege of using it for thirty days. If he then decides to keep it, he sends a payment representing one of a series of regular payments. If he is not satisfied with his purchase all he has to do is to notify the house to that effect and ship it back. The money he has paid is returned to him, including any expenses he may have incurred for carrying charges.

9. *Credit information in mail-order business.*—No onerous credit restrictions are imposed. The customer is not asked to give a complete history of his life but merely to tell how long he has lived in his present location. If he has lived there less than five years he is asked to give his previous address. He indicates his business or occupation and then gives the names of three references. Then just above the place in the order blank where he signs his name there is this statement:

"I have always been faithful in paying my obligations and am making this statement for the purpose of inducing you to grant me these terms, and I give you my pledge that you may feel safe in trusting me to pay as agreed."

Farmers who purchase machinery or equipment are in some cases asked to answer these questions also. "How many acres in your farm?" "Who owns it?" "Did you have good crops last year?" "How much are you worth over and above any debts you may owe?" "How much do you owe which should have

been paid on or before this date?" If for any reason the farmer does not care to answer these questions he can substitute for them a letter from his banker recommending credit.

There are some concerns like the Hartman Furniture and Carpet Company of Chicago who depart from the usual plan of credit instalment selling in that they will sell a great number of articles in one bill. They will furnish a house complete and stretch the payments over a period of time. They extend to people all over the country practically the same credit terms that local customers are offered.

In the case of such offers more credit safeguards are required than would be possible from the mere filling out of an order blank for goods and promising payment. After the order is received in such cases the customer is sent a note for the amount, secured by a chattel mortgage on the furniture and other items ordered. This note and mortgage must be acknowledged before a justice of the peace or magistrate. Then, after these papers duly executed are sent in accompanied by the amount of the first payment, the customer's goods are shipped. The customer receives also a blank book in which are entered the amount of the order and the initial payment. Each time he sends in a payment on account the customer incloses this book. Credit is entered and the book sent back to him month by month.

10. *Household appliances on instalment contracts.* It has for a long time been common practice for

piano and talking machine manufacturers to use the city department stores as an outlet for their products, selling on instalment contracts. A more recent development in the same general direction is the use of department stores to distribute household appliances of all kinds, washing machines, vacuum sweepers, motor-driven ironers, dish washers and the like, which are paid for in instalments. In such cases the manufacturer usually installs a representative in the store to demonstrate the appliance, answer questions and actually close sales. The buyer's contract, however, is not with the manufacturer but with the store. The manufacturer is enabled in this way to capitalize the store's name and patronage for the advancement of its own business. The form of contract used in such cases is illustrated here:

THIS AGREEMENT, made the .....day of .....19 , between JOHN WANAMAKER, NEW YORK, a corporation, hereinafter called the Seller, and ....., hereinafter called the Purchaser.

WITNESSETH:

1. That the Seller has this day agreed to sell and deliver to the Purchaser, and the Purchaser has agreed to buy from the Seller a certain article, described as follows:
.....No. .....
.....
at the agreed price of .....
Dollars, which the Purchaser agrees to pay to the Seller as follows:
.....Dollars ($.....) this day
.....
.....

.....
.....
.....
.....

and .....Dollars ($.....) on the .....day of each and every month thereafter until the said sum of ..... Dollars ($.....) together with interest, shall be fully paid.

2. The Seller shall place this article in the custody of the Purchaser at h.... house, No. ....., as personal property of the Seller, upon the distinct understanding and agreement of the parties that the title and ownership of said article shall remain in the Seller until the whole of the said purchase price, with interest, or any judgment obtained therefor, shall be fully paid. The Purchaser agrees to keep the article at the address aforesaid, and not to remove the same without the written consent of the Seller.

3. Upon default by the Purchaser in any of the above agreed payments or other breach of this contract, the whole of said purchase price shall immediately become due and payable at the option of the Seller.

4. Should Purchaser fail to perform any of the terms of this contract, then the Seller, its agents or servants shall have the option, without further notice or demand, to enter any place or places, where said article may be and peaceably take possession of and remove the same, and the Purchaser does hereby authorize the Seller so to do. All remedies herein contained shall be cumulative and not exclusive.

5. In the event of such re-taking, by legal proceedings or otherwise, the Seller may re-sell said article at either public or private sale and with or without notice to the Purchaser, any statutory provision to the contrary notwithstanding.

6. The said Purchaser shall not mortgage or assign h..... interest in this contract, or in any way encumber said article, or suffer any charge, lien or encumbrance to be placed thereon.

7. The Purchaser agrees to pay interest at the rate of

6% per annum on said purchase price from the date hereof, which interest, however, is to be computed only on the unpaid monthly balances of said purchase price.

8. Any waiver or extension by the Seller for any of said payments or covenants to be performed by the Purchaser, however, shall not be considered a waiver of the terms and conditions of this contract.

9. The contract for the conditional sale of the above mentioned article covers all and every agreement between the parties relating thereto, and the Purchaser acknowledges the receipt of a duplicate of this contract.

10. By signing this agreement, I, the Purchaser, assume all damage that may occur by fire or water to the above named article; or if while moving the same after its first delivery the article should meet with an accident, said damage will also be taken care of at my expense.

WITNESS our respective hands and seals this.....day of .....19 .

JOHN WANAMAKER, NEW YORK

By ..... (SEAL)

For Treasurer.

WITNESS:

By ..... (SEAL)

Purchaser.

11. *Instalment credits without a credit department.*—There are certain department and specialty stores, located in centers where there are available the services of "industrial" banks like those operated under the Morris Plan, which maintain no credit departments of their own, altho they sell the usual lines of pianos, phonographs and household appliances on instalments. In such cases, instead of assuming the risk of deciding for themselves on the customer's application for credit, they avail themselves of the ser-

vice of the local Morris Plan bank, maintaining in the store a representative of the bank whose business it is to make all contracts calling for deferred payments on purchases. In such cases the bank's representative, on accepting a customer's signed contract and a series of "acceptances," immediately advances to the store the full amount of the purchase and undertakes on behalf of the bank to take full charge of collecting the future payments, thus reimbursing itself. For this service it receives a percentage on the amount of the sales contract.

Under such an arrangement a merchant is relieved entirely both of the burden of financing a profitable volume of business done on instalments and of the cost of maintaining a credit department. The industrial banker thru a very practical extension of his long tested service opens up a new and profitable field for himself.

The store continues to carry the risk inasmuch as it assumes a contingent liability as the indorser of the customer's acceptance.

12. *Financing automobile instalment credits.*— The annual volume of purchases of motor cars and motor trucks during recent years represents a total investment that practically proves by its very amount that it has been reached by instalment methods rather than in lump payments of the sale price of the vehicles. It is stated that probably not more than one out of ten owners of either moderate or high priced cars or trucks pays in full for his car on de-

livery. The need for providing some means of financing automobile purchasers on credit has brought into existence a distinct type of credit financing institution. This new type of credit financing is carried on by the so-called "commercial credit" or "discount companies," which gives promise of a much more extended use in the future. The extent to which they are already being used is evidenced by the fact that there are more than a hundred such companies organized under state banking laws doing business in the city of Chicago, while New York has an even greater number. They are found now in nearly all parts of the country, wherever the need for them has been manifested, and it should be kept in mind that some of these companies deal also in other kinds of commercial paper growing out of the sale of pianos, furniture and other goods on the instalment plan.

The reasons for the rapid development of this type of financing company in the automobile industry are found in the nature of the distribution methods in the business. The automobile, despite the current assertions that it is a necessity, has always been looked upon by the commercial bankers as in a different class from staple products—as involving relatively large risks. Automobile dealers, as distinguished from the manufacturers, commonly have relatively small resources; they buy cars largely on credit and in time sell them largely on credit. It has been estimated, indeed that seventy-five per cent of the passenger cars and ninety per cent of the trucks are sold on time.

Since the demand for automobiles quickly falls off in times of business depression and since second-hand cars are subject to very heavy depreciation, commercial banks have not been willing to extend credit to automobile dealers in proportion to their requirements in periods of rapid expansion. Hence the opportunity for this type of automobile "banking."

13. *The wholesale methods of financing.*—There are two types of automobile financing operations to be considered. First, certain large credit companies extend what may be called wholesale credit to automobile dealers. Second, there are many smaller financing corporations which specialize in the making of retail loans secured by the instalment notes of the ultimate purchasers of the cars. Some companies, such as ordinary commercial paper concerns, engage in both types of operations as well as in other businesses.

The wholesale plan is designed to enable the dealer to secure the funds with which to pay the manufacturer for his product without waiting for sales to customers. In a sense this plan helps the manufacturer as much as it helps the dealer. The loans are made to the dealer, who gives his note to the financing company together with chattel mortgages on the cars in his possession. In some states instead of the chattel mortgage use is made of a "trust receipt" or a "conditional sales" agreement, the practice followed depending upon the variations in State laws.

Under such conditions when cars are stored upon

the dealer's premises the chattel mortgage covers each individual car in his consignment. These cars may then be disposed of only on terms laid down in the dealer's agreement with the finance company. The title to ownership of the car in such cases remains with the finance company, while the dealer acts in the capacity of an agent. He may even consummate the sale of the car itself in the meantime. While payments by the purchaser may still actually be made to the dealer who is the only person he knows in the transaction, they are accepted by the latter in trust for the finance company and immediately turned in by him as their agent. The dealer then is still held responsible for the loan for which he has given his note.

The dealer's credit standing is therefore of first importance. A careful investigation of the dealer's moral and business standing based on his statement showing his financial condition is a matter of course.

14. *The retail plan.*—The following is a typical illustration of how the finance company cooperates in the retail sale of cars. Assume that a dealer has sold a car for $5,640 and that the charges to the purchaser, including interest and other financing charges amount to $360, making the total "credit sale price" $6,000. Now assume that the purchaser pays down $2,400 and gives ten instalment notes of $360 each, payable monthly. He also executes a chattel mortgage or a conditional sale agreement in which the car, as well as the general assets of the purchaser, is

pledged as security for the loan. The dealer usually guarantees payment of the notes. The loan from the finance company then is typically 60 per cent of the value of the car and the purchaser's notes are paid in monthly instalments direct to the finance company. The retail purchaser is usually required to take out and pay for in advance fire and theft insurance and possibly collision insurance covering at least the amount of the loan for the time it has to run. Some finance companies add the amount of insurance to the "credit sale price," take out the insurance themselves in their own name and that of the purchaser jointly, allowing the purchaser to pay for his insurance in instalments just as he pays for the car.

15. *Source of loanable funds.*—The funds employed by the finance companies are procured in a variety of ways. A part of them is derived, of course, from the capital contributions of the company's shareholders, but this capital is employed mainly to serve as the basis for its own credit. Four different ways of securing loanable funds are therefore employed.

First, the company may borrow from commercial banks or thru commercial paper houses on its single name promissory notes without other security. Second, it may borrow from commercial banks on its promissory notes secured by the instalment notes of the purchasers of cars. The officers of the financing company frequently indorse the notes. Third, it may raise the funds by selling the company's unsecured

debenture bonds in the investment market. Fourth, it may secure the money by selling in the investment market collateral trust notes or bonds.

Under this last plan the company assigns the notes received from its customers together with the chattel mortgage or other documents to a trust company which holds them in trust as collateral for the bonds to be issued. Guarantees (by the various dealers to whom the company has lent funds on note security) to the effect that both principal and interest will be promptly paid are also turned over to the trust company. The financing corporation then issues its own obligations, secured by these commercial notes, mortgages and guarantees and offers them for sale in the general investment market. They are usually issued as short term serial notes, some of which mature every few months.

16. *Security behind investment company bonds.*— In the marketing of its bonds the financing company must naturally make its strongest appeal to investors by showing the security behind them. The following is quoted from the prospectus of such a company offering its six per cent bonds based on instalment piano contracts to show how the facts are presented.

"Good as is commercial paper in general, there are some classes of paper rightly regarded as better than others. It is to what has always been considered the very best class of paper—that originating from the sale of pianos—that the Security Company confines itself. For a hundred years, through wars, panics, and long slow business depressions this paper has proved itself perfect—as "paying out" at one hundred cents on the dollar.

"A man buys a piano, paying twenty per cent down and signing a contract which says that he is to pay the balance in equal monthly instalments, and that, if he fails to pay, the dealer is to have the right to come and take the piano away from him. This contract the dealer endorses and, with others like it, turns over to the manufacturer in payment for more pianos. It is this paper which the manufacturer —needing to turn it into cash and being unable to do so at his bank because the paper runs an average of two and one-half years—puts his own endorsement on, and sells to the Security Company.

"The paper back of the Security Company bonds, it will thus be seen, besides remaining a mortgage on the merchandise until the last dollar is paid, has on it the name of a responsible individual, the endorsement of a responsible dealer and the guarantee of a responsible manufacturer.

"Is it any wonder that the Security Company has never suffered the loss of a dollar on any of the paper it has bought?

"As the Security Company buys the paper, it makes it up into budgets of $125,000, care being taken to diversify the paper that goes into each budget, geographically and otherwise.

"Against each such budget of $125,000 of paper deposited with the Trust Company in New York or the Trust Company in Chicago, the Security Company issues $100,000 of its own bonds.

"Under the trust agreement the margin of security must be at least twenty-five per cent. As a matter of practice it is maintained at considerably more than that.

"All the paper back of the Security Company bonds is at least twenty per cent paid—in other words represents not over eighty per cent of the actual sales value in merchandise. Against this eighty per cent the Security Company issued its bonds to the extent of only eighty per cent. The bonds, it will thus be seen, are issued to only sixty-four per cent of the actual value of the merchandise.

"As soon as the paper has been deposited with the trustee,

instalment payments begin to come in on it. By the end of three months more than enough has come in to pay off the first $10,000 of bonds, by the end of six months more than enough to take care of the second $10,000 of bonds, and so on.

"The collateral back of the Security Company Bonds, it will thus be seen, is self liquidating. It is not as with bonds secured by land, buildings or anything else that must be SOLD to turn it into cash. Automatically, and in time to meet the maturity of the bonds it secured, the paper turns money. The bonds come due, and there, in the hands of the trustee, is the cash with which to pay them."

17. *Justification of instalment credit.*—Instalment credit is a force to be reckoned with in the business life of the country. Like many other methods and types of enterprise it has developed from rather inauspicious parentage, but has achieved a standing that takes it entirely out of the realm of dubious or questionable schemes. As a supplement to ordinary commercial credit it makes possible a large volume of business that could not be done on any other basis. To the buyer it makes available a much larger proportion of his moral credit, for he is enabled to buy on his general standing in the community and his future ability to pay, rather than upon the basis of resources he has already available. In this respect it serves a useful purpose in the life of the people, tho it is also an open door thru which abuses may creep in. Unchecked it might lead to an unfortunate expansion of buying by those whose wants are bigger than their incomes. The standards of credit analysis, however, have erected a fairly efficient bar against

unwise purchasing. Those who bid for permanent success in business, built on instalment credit, have no desire to complicate their business by selling to those who are unable to pay as notes, acceptances or other evidences of indebtedness fall due.

REVIEW

Compare the general characteristics of articles sold on the instalment plan with those commonly sold for cash or on credit.

Discuss the usual instalment contract with a local customer. On what basis is credit granted?

Discuss granting of credit on mail order instalment sales. What are the strong and the weak points of this method?

How are instalment credit sales effected as an adjunct to department stores maintaining credit departments and those which do not use charge accounts?

Explain the method of selling automobiles to dealers and consumers, including the operation of finance companies.

CHAPTER VI

GRANTING CREDIT TO BUSINESS ENTERPRISES

1.—*Personal and business credit.*—Granting credit to the consumer or user is one thing, granting it to a business enterprise is another. In the latter case the amounts involved are usually larger, and because of this the credit rests upon a broader foundation. The considerations which affect the credit of the consumer reappear because we can never separate the personality of the man from the business in which he engages. When the retailer grants credit to the consumer the latter's personal characteristics must be deduced from his manner of living, but when credit is granted to a business man for business purposes we find these qualities tinged by and tested by the way in which he conducts his business. New measures of judgment appear which are of decisive influence in granting or withholding credit.

Whether credit is granted to a consumer or to a business enterprise for business purposes, the fundamental considerations, ability, integrity, and financial strength, or, as they have already been expressed, capacity, character, and capital, must be considered. There is, however, a difference both in the emphasis placed upon each of these factors and the exactness

of the information that can be secured in the different circumstances. The retailer dealing with consumers must act upon the general reputation of his customer rather than upon specific knowledge. The credit granted is usually related to living expenses, not to business operations. Hence the applicant's general reputation and especially his habits of payment, so far as they can be ascertained, count for more than the estimate of his business ability or surmises as to his wealth. While such ability and wealth when present are guarantees of ultimate payment and most reassuring to the dealer who gives credit to the consumer, the nature of the relation gives the dealer no right to probe very far into these matters by questioning the creditor.

On the other hand, when credit is granted by one business house to another for the purpose of enabling the latter to conduct its business operations, the situation is quite different. The credit grantor must take into consideration a large number of factors which affect the profitableness and operation of the customer's business. The sources of information on these matters will be discussed in the next chapter. We are here concerned with its character and its bearing upon the request for credit.

2. *Diversity among credit applicants.*—The consideration of business credits usually centers around credits granted to retail dealers. They represent the most numerous class of applicants, and because of this it is customary to explain credit principles by

reference to their peculiar needs. Nor is there any impropriety in choosing the most usual applications of credit as illustrations of these fundamental considerations. But it should be remembered that the principles are of general application, tho modified by the special circumstances of the applicant, and that all applicants are not retail dealers. There are other factors in the business world who seek credit, either directly from those who furnish them goods, materials or supplies, or from the banks. They are the manufacturers and the jobbers, and their special situation must be considered.

3. *The manufacturer.*—As a credit risk the manufacturer presents his own peculiar problems. In order to gauge his capacity and the adequacy of his resources it is necessary to have a thoro understanding of the nature of his operations. The amount of working capital required depends upon the size of the business and the rate of turnover. This raises a train of questions. What is the volume of business? On what terms are the materials bought? How large a proportion of the cost is labor, paid for in cash? What are the running expenses? How long in advance of their use must he lay in his stock of materials? How long does it take to turn out the finished product? Does he manufacture for immediate delivery or is it necessary for him to make outlays for materials, labor and current expenses in the production of goods to be accumulated for a long period in advance of the time of shipment owing to the sea-

sonal character of the demand? What are the terms of sale?

As to the prospects of the business and particularly the inherent risks involved, many questions also occur. It is essential to have a very definite understanding of the individual concern as well as to know the business outlook in the line manufactured. Among the factors which commonly play an important part are the following: Is it a staple commodity or one affected materially by fashion's whims? Does the manufacturer work on orders in hand or does he make up stock relying upon his judgment in estimating quantities and kinds? Does he figure his cost correctly? Is the margin of gross profit large or small? Are the overhead expenses in due proportion? Can the machinery be used in the manufacture of other articles or is it highly specialized and subject to heavy writing off for physical depreciation and obsolescence? What is the labor situation?

Besides these specific points the credit man considers the applicant's general qualifications as a business man and particularly his ability to manage labor and to manufacture economically and efficiently.

Frequently the manufacturer occupies a stronger financial position than those from whom he draws his raw materials. This is especially true when he gathers his raw materials from innumerable small producers. If he needs credit he will in many instances secure it from the banks rather than from those who

sell him. His credit needs are then peculiarly a problem of the bank credit man.

4. *The jobber.*—In the older scheme of distribution, as has been pointed out in the Modern Business Text on "Marketing and Merchandising," the jobber often towered above the producer from whom he secured his wares as well as the retailer to whom he sold them. He was, in many cases, banker to both of them and such a relation is not unknown today. The growth of manufacturing concerns with a nation-wide and often an international market for their goods, has made the jobber relatively less important. The problems of the jobber are, in some respects, like those of the retailer. He must exercise good judgment in buying, have an ample selling outlet, and conduct the business economically and within his financial strength. However, in some lines the merchandising problem of the jobber is intensified. He may specialize in one or a few lines, the demand for which is subject to sudden fluctuations, due to fashion changes, seasonal conditions, or other reasons. The jobber places large quantity orders in advance with the mills, assuming the risks, and relies upon selling to the retailer or manufacturer who prefers to buy as he needs the goods.

When studying the jobber's merchandising problem, his buying power and connections and his selling field must be understood; in connection with the selling, the tendency of manufacturers in some lines to

extend their direct-to-retailer sales operations must be considered.

It is essential that the credit analyst be well informed concerning the applicant's character, ability, experience and the nature of the business as well as the scope and methods of the operations.

5. *Importance of business methods.*—In sizing up any mercantile credit risk there are three distinct groups of factors to be taken into account. The first involves qualities which are in the manager of the business; the second includes those elements which are peculiar to his enterprise; and the third consists of peculiarities of the line or type of business in which he is engaged.

The credit man of a manufacturing or wholesale distributing company soon acquires a very clear idea of the business capacity of the dealers who buy from his house. Thru his analysis of financial statements and other less obvious signs, he recognizes at once whether or not a man is a good merchandiser. A very great deal depends upon this estimate by the man directly responsible for the granting of the credit. It is plain that if a dealer is a good merchandiser he can secure a much more generous amount of credit from a wholesale house, provided, of course, he is in a line of business in which he can dispose of the goods purchased within the usual credit period. On the other hand, the buyer who is slow in selling his goods cannot rely upon the proceeds of the sale to meet his obligation. In the latter circumstances, the

credit man knows that if credit is granted, he must rely to a large extent upon the other resources of the debtor. It is clear, therefore, that every applicant for credit must be measured by an estimate which the credit man forms of the way in which he conducts his business.

6. *How merchandising ability affects credit.*—If men in the same lines of business conduct their affairs with different degrees of ability and success, this must have a marked effect upon the credit which is granted to them. The usage of any given trade generally prescribes certain definite credit periods. It is, as a rule, hardly within the power of the seller to extend the limits of such periods to dealers who may be good pay but who are slow in reselling their purchasers. In fact, sellers cannot afford to make such extensions unless they are compensated by an increase in the prices. Since such an increased price would involve not only interest upon the capital so invested but also a compensation for tying it up in such a way that the seller could not use it during the interval, the latter is unwilling to make extensions of credit on this basis. The dealer, too, in such a case, would feel that he was being discriminated against, and would refuse to pay a higher price. Variations in credit terms are not, therefore, so frequent as variations in the amount of credit extended. The poor merchandiser will not be granted so large a credit as the good merchandiser. His methods of doing business do not entitle him to the same consideration, since the seller must rely less

on his business ability in disposing of the goods and more upon his general financial position.

7. *Knowledge of business.*—Before granting credit to the retailer, the concern that exercises due care in selecting its credit risks uses every means at its disposal to assure itself that the credit seeker knows his business. What this expression means depends upon the standard of the investigator. For example, it may mean nothing more than that the seeker of credit knows quality and prices. On the other hand, it may imply a knowledge of finance, markets, materials and manufacturing processes. Furthermore, it may, as we have already noted, take into consideration the fact that the dealer has the sales ability to turn his capital often enough in a year to make his venture profitable. The greater his ability along these lines the surer he is to prove a profitable risk to the manufacturer or wholesaler. Stagnation has been responsible for more than one failure; and by stagnation is meant not only unprogressiveness in manufacturing and selling in the case of manufacturing enterprises, but also the practice of keeping on the shelves obsolete or soiled merchandise, in the case of the retailer.

8. *Judgment in purchasing.*—A few years ago it was the policy of many wholesale houses and manufacturers to allow or even to encourage their salesmen to overstock a customer. As a result, many business failures occurred that were directly due to over-buying. Today the tendency on the part of well-managed houses is to work with the credit seeker

and prevent him from buying more merchandise than he can dispose of within the customary credit period of the line of business in which he operates. The careful retailer, by keeping a close record of his sales, should be able to foretell with reasonable accuracy about how much of a certain kind of merchandise he can sell in a given number of weeks or months and, having determined this, he should limit his purchases accordingly. To pursue any other course is to court disaster. Similarly the manufacturer must exercise care in providing for a sufficient supply of raw materials to carry out his contracts. This is particularly true where he must deliver definite quantities at fixed prices over a long period of time. If he fails to buy in sufficient quantities, a contract expected to yield a handsome profit may force him to the verge of insolvency and change his concern from a gilt-edged to a questionable risk. On the other hand, to lay in vast quantities of raw materials on a purely speculative basis is not likely to improve his standing as a credit risk. No man has a right to speculate with another's capital.

9. *Age and experience.*—It is safer to ride with a motor driver who has put his car over 20,000 miles of road than with a man who has driven only 500 miles, even tho the latter may be a more careful driver. The former has experienced so many different road conditions that he instinctively knows what to do when danger arises. In like manner the more mature merchant is not exposed to the errors in judg-

ment that are likely to occur to his inexperienced competitor. The matter of age and experience cannot be left out in considering the business ability of the credit applicant. There are counter considerations which must not be disregarded. It is worth noting that the younger man is more likely to be willing to be taught, while the man of longer experience may dislike to adopt new merchandising methods.

10. *Financial ability.*—To be credited with having financial ability, any business man must always have funds on hand to meet his bills for merchandise or raw material as they fall due. To do this he must collect his accounts closely and maintain a definite relation between sales and outstanding indebtedness. He must not attempt to do a larger business than his capital warrants. If he does, too much of his working capital will be tied up in book accounts and these are always difficult to liquidate quickly when cash is needed.

The dealer who is a good financier keeps exact records of expenses and the cost of doing business. He practices economy at all times. He does not hesitate to sell old and shop-worn stock at a sacrifice rather than allow it to accumulate. He carefully arranges the distribution of his payments due so that he is reasonably sure to have funds on hand to meet them. Many dealers have been forced into the hands of a receiver merely because they have failed to make a proper distribution of the dates for maturing bills payable. These should be distributed over the year

so that they may be paid when due without embarrassment or danger to the business, and so that the dealer's credit at the bank may be used to the best advantage.

Another evidence of a merchant's financial ability is the degree to which he has cultivated confidential relations with his bank and the way in which he keeps informed as to markets and industrial conditions. A dealer's relations with a bank are reciprocal; for while the bank can help him in a number of ways, it receives in return information of interest to it which also may be of value to its other customers.

An untarnished reputation for meeting financial obligations is one of the greatest assets that a business man can have. Once his reputation becomes clouded, it is extremely difficult, in fact it is impossible to restore it to its former condition. This is the reason why concerns that watch their credit risks carefully make inquiry from others who have done business with the credit seeker to secure as much knowledge as possible of his payment habits.

11. *Outside ventures.*—The warning of the old adage about falling between two stools applies aptly to the business man who imperils his standing by entering into business deals outside the interests of his own enterprise. Yet it must be admitted in this connection that success covers a multitude of sins. Many highly successful business men are interested in more than one business. In fact, their outside interests serve only to strengthen their general credit

standing. Judgment regarding the influence of outside ventures upon any mercantile risk can be formed only after a careful survey of the general financial condition, the personality, and the evidences of financial ability displayed by the applicant for credit. If a dealer invests in outside ventures which weaken his financial condition and divide his attention, his account will bear watching. In spite of any temptation to increase his income by reaping a quick profit on some outside scheme the careful merchant should do nothing to imperil his credit. Delinquency and loss of standing will do him more harm than a loss of possible profit. Furthermore, he should never go so close to the limit of his resources that there is no reserve from which funds may be obtained in an emergency.

The most detrimental of all outside ventures are those in which business men sometimes indulge secretly. In almost every case these turn out to have been of the highly speculative, wild-cat variety. Often they are last, despairing efforts to save a wreck. The discovery that an applicant for credit, or even a debtor of formerly good standing is indulging in outside ventures of this kind should at once challenge the attention of the credit investigator.

12. *Unjust claims.*—Few dealers perhaps seek credit deliberately with intent to defraud, but many are poor credit risks because of their slip-shod methods. The most troublesome group, however, is composed of those who take advantage of creditors in

other ways. If they find themselves over-stocked, they will cancel orders and return goods for slight or imaginary causes. They will make unjust claims for rebates and will take cash discounts on their bills, long after the discount period has expired. In the long run, customers who deal fairly must bear in the form of increased prices at least a part of the losses which deprive the wholesaler of his just profits. Such abuses of credit are therefore important to all who use credit either as grantors or as receivers. All should be equally anxious to put a stop to such practices. As competition has reduced profits wholesalers have taken a definite stand against these abuses and are refusing to deal with merchants who make use of such unfair practices.

13. *Ability to forecast trend of trade.*—Ability to forecast the trend of trade and, in the case of a manufacturer, to turn attention to the production of goods for which a present demand is being developed, augurs well for the success of an enterprise and must add measurably to the credit standing of the company or firm that displays it. Fortunes have been made thru a correct anticipation of a fad, a fashion, or a want created by peculiar conditions. This is a matter in which degrees are of great importance, since over-readiness to cater to what may prove merely a local and short-lived fancy on the part of the public involves risk, the extent of which is measured by the value of the material and labor employed. Such errors of judgment, however, may take place even in

the production of staples. To maintain standing as a good credit risk a manufacturer must keep in touch with market conditions in his line of trade and with the trade situation in general so that he may not find himself with a large quantity of manufactured goods on his hands for which there is no present demand except at sacrifice prices, thereby imperiling his profits and exposing himself to financial embarrassment.

Exactly analogous arguments apply in the cases of wholesalers and retailers. Ability to forecast the trend of trade is merchandising ability and of that we have already spoken. The gist of the whole matter is that conservatism, alertness and business acumen must at all times be combined to secure the best results in buying.

14. *Business resources.* Upon turning to the factors that are attributes of the enterprise to which credit is to be granted the most important is that of its resources. This is a matter to which we shall find it necessary to give full consideration at a later stage of our study, so for the present we shall regard only the sources of the capital employed.

During the World War a number of small concerns sprang up and many individuals who had saved or inherited a few thousand dollars went into business. The history of many of these ventures bears out the old theory regarding the importance of capital. Those which have been most successful are the ones that began on capital that by its acquisition showed desirable characteristics in its owner. In the opinion

of most credit men, the man who starts business with a capital that is the result of frugality and the saving of many years is a far better risk than the man who has inherited the same sum. The knowledge acquired during the years of saving does not desert a man when he starts to use his savings in business for himself. It is practically certain that he will not spend his hard-earned dollars foolishly, but will continue his practice of frugality. The beginner in business who is in possession of capital before he has learned how to take care of it is in grave danger of losing it thru ignorance and inexperience. Unless he is of an unusually canny disposition, he is almost certain to accept at face value propositions that a man of perhaps no greater business experience, but of confirmed saving habits would examine from all angles and then reject.

15. *Equipment.*—Another factor peculiar to the enterprise rather than to the personality of the business man which enters into credit granting is the equipment of a credit seeker. During the war period there was a tendency on the part of manufacturers to enlarge their equipment and manufacturing facilities in order to increase correspondingly their profits. There have been a number of instances where the quick assets of an enterprise were materially reduced, and just prior to the period of readjustment a number of plants were built that are now lying idle because manufacturers based their judgment on the abnormal demand for their products. But, on the

other hand, well-kept and modern machinery suited to the needs of the business is essential to economical and profitable production. To meet competition, goods must be produced in proper quantity and quality, and it is within the province of one to whom application for credit is made to determine what is legitimate enterprise as contrasted with undue optimism.

16. *Location.*—Both the manufacturer and the retailer are seriously affected by the question of location. The former must take into consideration his distance from the markets, railroad facilities and the question of raw materials together with the supply of labor available; while the latter must weigh the desirability of location against the cost of rent. Conservative retail merchants take the stand that it is rarely desirable to move as it is not often possible to take to the new location more than a very small part of the trade they have built up. Of course, if changes in the character of the neighborhood come and the move is absolutely necessary, it must be made. The redeeming feature of such forced changes is that moving to the new location has often been the means of turning a small business that was having difficulties in meeting its obligations into a large and prosperous one. The keenly wide-awake credit man never ceases to be on the lookout for opportunities to help in the crucial times of a retailer's experience. Problems of location frequently offer him fine opportunities to give the benefit of his experience and so cement the trade of a prosperous customer to his house.

17. *Insurance.*—No merchant is entitled to credit who does not carry sufficient insurance to protect his creditors against possible loss by fire. The amount of insurance carried as well as the existence or installation of appliances to reduce the fire hazard are matters of prime importance to the concern considering the granting of credit. Other forms of insurance, such as burglary, flood and tornado, depend upon the nature of the business and local conditions but they will receive consideration by the able business man.

18. *Advertising.*—Care should be taken to consider the amount of advertising and the results that are obtained from it by the retail merchant. Too much or too little advertising, the mediums used, and the quality of the copy, are all important in reviewing the advisability of opening credit relations. If advertisements are not properly placed or are indiscriminate, they may add materially to the cost of marketing the product and so cut down or wipe out the profits from sales.

19. *Turnover.*—The third group of factors for our consideration, those inherent in the line of business in which a credit applicant is engaged, comprises two chief divisions, namely the effect of turnover and the customary credit terms.

The rapidity with which dealers in any line of business dispose of their stocks varies, but it is coming to be recognized more and more clearly that in each line there is a certain average or normal turnover. If a merchant has been successful in passing beyond the

average rate he may be granted more than the average credit in relation to his resources. If, on the other hand, he has fallen below the average turnover, the prudent manufacturer or wholesaler will be obliged to curtail more or less the credit which is to be granted to him. This explains the fact that two men with equal amounts of capital invested in business may be able to secure very different amounts of credit from the manufacturers and wholesalers from whom they buy. The credit man of a wholesale house or a manufacturing concern often has to deal with applicants who are all in the same line of business, with the conditions of which he is familiar. He knows that there is in this line a normal type of successful merchandising, and he applies this knowledge when called upon to pass upon credits, giving the good merchandiser the benefit of additional accommodation.

The credit man of the bank must have a still broader outlook. He is concerned not with one type of enterprise but with a large number of concerns in various lines of business. He must know something of the general characteristics of each of the leading lines of business. Some of this information he acquires from his own experience but he can also secure a great deal from the many and varied sources with which he is in contact. Somewhat in the same way the man in charge of credit granting for a line which is sold by stores carrying many other varieties of goods finds it necessary to know something of the

normal turnover in these other lines in order that he may get some idea of the customer's ability. Thru the work of the credit men's associations, the bureaus of business research of the universities, and the work of special advertising agencies and special research organizations, there is coming into existence a vast amount of knowledge about the detailed operations of the various classes of business enterprise. None of these sources of information can safely be neglected until the fact has been definitely established that it has nothing to offer that will be of assistance.

Retail stores are not identical in character. Each line presents its own problems. The principles are the same but the routine and conduct of the business are quite different. At this point we are chiefly interested in knowing how these typical conditions of turnover affect the granting of credit.

20. *Amount of credit affected by turnover.*—The fundamental nature of mercantile credit is an advance to the dealer to be paid in whole or in part from the funds derived from his sale of goods entrusted to him. If the duration of credit is sufficient, the advance can be repaid wholly from the proceeds of the sales. If the credit period is a brief one, the advance must be repaid from other resources of the dealer. These features must be taken into consideration in granting credit for short periods to persons in the different lines of business. This is the particular problem of the bank credit man who must pass upon loans that are made for short periods. Other things

being equal, he will be more disposed to grant a larger credit to the dealer whose business has a rapid turnover than to one where the turnover is slower.

21. *Duration of credit; dating.*—In fixing the duration of credit manufacturers and wholesalers take into account to some extent the fact that credit cannot be repaid wholly from the proceeds of the goods until they have been sold. The credit customs in different lines of trade vary considerably. The usual credit periods are thirty, sixty and ninety days, the longer periods being granted in lines which are relatively slow sellers. A further extension is frequently given in the seasonal lines by the practice of dating accounts ahead. Woolen piece goods are sold at thirty days, sixty days or four months credit, but with dating on advance orders of January 1st and July 1st. Thus a man who buys in August at thirty days credit has his bill dated January 1st of the following year. As a general rule, goods yielding the larger profits are accorded the more liberal credit terms.

REVIEW

How does business credit granting differ from granting credit to the customer?

Describe credit needs of the manufacturer and jobber.

Explain the various factors in the personal qualifications of a business man that affect his credit.

What is the relation of individual turnover to credit?

How does the turnover in different lines of merchandising affect the credit usually granted in them?

CHAPTER VII

CREDIT INFORMATION

1. *Sources of information.*—Credit is frequently granted to a person, firm or corporation that is not entitled to it because the information upon which the creditor has based his action is either incomplete or misleading, or both. When the credit grantor is in possession of complete and specific information he is less likely to make errors in judgment when passing on an application for credit than when he has neglected to exhaust every source of facts. The wide-awake credit man, therefore, uses every opportunity to post himself as fully as possible regarding the actual condition of the applicant in everything that has a bearing upon his standing as a credit risk.

The value of the information depends upon the source from which it is received. With certain reservations, what is learned from the statement of third parties is of more value than what the credit seeker tells about himself. It is natural that the latter should be optimistic, and it is not to be expected that he will furnish information about himself that would prejudice his chances of receiving credit favors.

On the other hand no one knows so much about a man's business as the owner himself and, after all,

the information received from him is the basis upon which credit is granted. But this information must be put in writing, and its central point is a detailed statement of his business in account form. This is not accepted on his say-so but is subject to critical tests as to its inherent probability and is supplemented by information gathered from other sources. In many such statements some of the assets will be given a valuation that is at least fully equal to their current market value while it is possible that certain facts may be withheld.

It is not necessary that in such cases there should be any intentional dishonesty on the part of the credit seeker. Even with the best intentions, an overweening confidence in himself may lead him to color his statement in such a way that it presents far too rosy a picture of his financial condition.

An intentionally dishonest statement must always be expected to show up occasionally. In the hands of an expert credit examiner it soon betrays itself, for altho the actual figures may be so juggled that no discrepancy can be found, the impression made by the statement as a whole will oftentimes fail to check up with the results of inquiries which have been made thru other channels.

Besides the financial statement or, as it is sometimes called, the property statement furnished by the applicant for credit, there are other sources available:

1. References supplied by the applicant.
2. Information supplied by the mercantile agen-

cies, which may be in the form of rating books, weekly or monthly information sheets, or special reports.

3. Salesmen's reports, obtained from the sales representatives of the house who sell a customer.

4. Ledger information obtained from credit interchange bureaus or from houses selling the same trade.

5. Information obtained thru reports from local banks or attorneys.

While these will be considered in this order after a discussion of the financial statement, it is not intended thus to gauge their relative importance. Well informed credit investigators must base their work on common principles, but differences in disposition and temperament and the distinctive information desired may lead to a preference of one source above another.

2. *Creditor's right to information.*—When a wholesale house or manufacturing concern extends credit to a retailer it lends some of its capital to his business and comes to occupy a position that is in effect similar to that of a partner in the enterprise. Having such a relation to the business the creditor is entitled to full information about how it is conducted, so that he can assure himself regarding the facilities the dealer has for the disposal of his goods at a profit and his ability and willingness to pay for merchandise purchased when the account becomes due. Since the transaction is mutual, in that the wholesaler must have an outlet for his goods and the retailer must be able to obtain goods on credit for resale, the latter should be glad to give his creditors full information

so that intelligent cooperation may be possible. The credit man, in his desire to promote sales, aims to extend as much credit as may be safely granted and a prudent business man should not want more. A business man will suffer more from too much than from too little credit. It is in the interests of both that the decision be based on an understanding of all the facts.

Modern developments have led men to see that credit thrives where the freest light has been admitted to the conditions which surround business transactions. The fact that business today is done on a smaller margin of profit has added emphasis to this view. For that reason, every precaution must be taken to insure the payment of all bills at maturity, and proper caution in securing full information before an account is opened saves two-thirds of the work of collecting it when it is due.

3. *Property statements.*—A definite and properly correlated statement of the financial condition of an enterprise has reached its present dignity and usefulness only within the last decade or so. In times past, wholesalers were accustomed to request the property statement with an apology, as it was regarded by many dealers as a personal insult or an unwarranted attempt at prying into their business. The statement was either refused or rendered with very bad grace. This attitude has now disappeared almost entirely. Any business enterprise seeking credit expects to render a financial statement or refer the credit grantor

to a professional accountant who is in possession of all necessary information regarding its affairs. Not only is the initial statement regarded as a mere matter of routine, but the practice of providing supplementary statements at certain definite times, or upon request, is becoming more general and arouses far less antagonism or even criticism than it did a few years ago. There is a difference of opinion as to how often the signed property statements should be requested. Some credit men ask for them only when information obtained thru other sources is inadequate or when circumstances of a suspicious nature make such requests imperative; others require them at the time of opening the account; while still others require one from each of their customers, new or old, once a year or oftener.

4. *Forms of property statements.*—There are a considerable number of forms of property statements in use, which have some measure of authority. The American Bankers Association has commended certain forms which are widely used by the banks. For use in commercial circles the National Association of Credit Men has from time to time indorsed and approved several forms. These forms include a special form for corporations and for partnerships tho a combined form is also provided. The latter form is illustrated on pages 125 and 126.

In dealing with smaller houses elaborate forms have proven in many instances more of a burden than a help. Recently, therefore, an abbreviated form has

been adopted of which the first page is illustrated on page 127. The form is turned up like a legal document and the reverse contains a space occupying about one-third of the sheet for the purpose of carrying out the injunction at the bottom of the page here reproduced. These columns call for the names and addresses of other dealers from whom purchases have been made, and the amount owing to each, in two columns, one of which is headed "open account," the other "notes." After a space for the remarks the rest of the sheet is blank except for an indication where a postage stamp is to be put. It will be noted that at the points marked A, B, and C the form is provided with flaps, that at point C being gummed, so that the form can be folded and sent thru the mails without an envelop, producing incontrovertible evidence of having passed thru the mails in case use of the mails for fraudulent purposes is subsequently alleged.

It is not necessary at this point to discuss the significance of the information here given as this forms the subject of Chapter IX. It may be noted that the work of the National Association of Credit Men is largely educational. In this connection a statement contained in a special folder issued by the Association and entitled the "Reciprocal Value of a Signed Statement" is so pertinent that it may be quoted:

A merchant who desires to serve his own best interests should recognize that his most valuable possession, apart from his actual assets, is a sound, substantial and unquestioned reputation as a credit risk, and *that* under the pre-

"Large assets are not always necessary to the creation of credit; what is most desirable is, that credit be in relative proportion to the actual assets."

PROPERTY STATEMENT

TO

"The giver of credit is a co-tributor of capital, and becomes, in a certain sense, a partner of the debtor, and, as such, has a natural right to complete information of the debtor's condition at all times."

Form Adopted and Recommended by the National Association of Credit Men

For the purpose of obtaining merchandise from you on credit, I (we) make the following statement in writing, intending that you should rely thereon respecting my (our) financial condition as of (Date)_____19____

(All questions should be answered. When no figures are inserted, write word "None.")

ASSETS			LIABILITIES		
Cash in hand			For MERCHANDISE:		
Cash in bank			Accounts owing not due		
Accounts owing by customers, good and collectible, not pledged or sold			Accounts owing past due		
Notes owing by customers, good and collectible, not pledged or sold			Trade Acceptances payable		
Trade Acceptances receivable, not pledged or sold			Notes payable for Mdse.		
Merchandise: (not on consignment or conditional sale.) (How valued; Cost_____ Market_____)			For BORROWED MONEY:		
			Notes payable to banks		
			Notes or debts payable to others (including relatives and friends)		
Other quick assets:			Deposits of money with us. (Describe)		
(Describe)					
			Owing for Wages and Salaries		
			Owing for Taxes (city, state and federal)		
			Owing for Rental		
			Owing for Insurance Premiums		
TOTAL QUICK ASSETS			TOTAL QUICK LIABILITIES		
Machinery: (How valued; Cost_____ Depreciated_____)			Debt secured by mortgage on land or buildings		
Fixtures and other Equipment. (How valued; Cost_____ Depreciated_____)			Debt secured by chattel mortgage or other liens		
Land and Buildings as described below			Debt secured by judgment		
			Other liabilities:		
Notes and Accounts owing from members of firm, employees, or others not customers			(Describe)		
			TOTAL LIABILITIES		
Other assets:			NET WORTH		
(Describe)			*Capital Stock { Preferred		
			Common		
			Surplus and Undivided Profits		
TOTAL ASSETS			TOTAL		

What books of account do you keep?_____

Was this statement made from those books?_____ Do you keep cost records?_____

Do you sell or pledge your accounts to creditors, banks, finance companies or others?_____. If so, what amount is so sold or pledged? $_____What amount of your accounts have you sold or pledged during the past twelve months? $_____

Are any creditors secured by mortgage or lien of any sort?_____ If so, how?_____

Are any claims in attorneys' hands or suits against you?_____

Have you merchandise on consignment or conditional sale?_____ If so, what amount? $_____

If business property is leased, for what term and what rental?_____

Name and locality of your bank or banks_____

Location and kind of business_____

Is your business incorporated?_____ If so, under laws of what state?_____

Previous business experience_____ Where_____

It is important that every question on both sides of this sheet be correctly answered and that the blanks be carefully filled in. In answering questions involving amounts write the word "none" where figures do not apply. You will find it advantageous to keep a copy of this statement for comparison with the showing you will be able to make a year hence.

*Capital stock item to be filled out only by corporations.

INSURANCE

On Merchandise $_____ On Buildings $_____ Machinery $_____ Fixtures $_____

Other Equipment $_____ Employers' liability $_____

Is any insurance assigned?_____ What amount?_____ To whom?_____

Amount of life insurance for benefit of business $_____

With what companies_____

SUMMARY OF PROFIT AND LOSS

Inventory of Mdse. beginning of fiscal year (not including fixtures or equipment)			Sales last fiscal year		
			Income from all other sources		
Cost of Mdse. purchased during the year			Inventory of Mdse. at close of year		
			Total Income for year		
General expenses including salaries, losses, etc.			Less Total Expenses		
TOTAL EXPENSES			NET PROFIT FOR YEAR		

RECORD OF LAND AND BUILDINGS

Title in name of	Description and location	Book value	Assessed value	Amount of Encumbrances	To whom

BUY PRINCIPALLY FROM THE FOLLOWING CONCERNS

Names	Addresses	Amount Owing	
		Open Account	Notes

Names and Addresses of Partners, or if Corporation, of Officers_____

REMARKS:

The foregoing statement has been carefully read (both printed and written matter) and is in all respects complete, accurate and truthful. It discloses to you the true state of my (our) financial condition on the date above stated. Since that time there has been no material unfavorable change in my (our) financial condition; and if any such change takes place I (we) will give you notice. Until such notice is given, you are to regard this as a continuing statement.

Name of Individual, Firm or Corporation_____

Signed by_____

Street_____ Town_____ State_____

Date of signing statement_____ 19____

Form 31

C

PROPERTY STATEMENT TO

[FORM ADOPTED AND RECOMMENDED BY THE NATIONAL ASSOCIATION OF CREDIT MEN]

For the purpose of obtaining merchandise from you on credit, I (we) make the following statement in writing, intending that you should rely thereon respecting my (our) financial condition as of (Date)_____ 19___

ASSETS	DOLLARS	CENTS	LIABILITIES	DOLLARS	CENTS
A Cash on hand			OWING FOR MERCHANDISE: On open account not due		
Cash in bank			On open account past due		B
ACCOUNTS owing from customers collectible			On notes and acceptances payable		
NOTES owing from customers collectible			OWING FOR BORROWED MONEY: To bank		
Merchandise, (How valued: Cost or Market?)			To others		
Fixtures and equipment			Owing for rental		
Land and buildings as described below			Owing for wages and salaries		
Owing from members of firm, employees and others not customers			Owing for taxes		
Other Assets			Owing on land and buildings		
			Other debts to relatives and others		
Total Assets			Total Liabilities		

RECORD OF LAND AND BUILDINGS

TITLE IN NAME OF	DESCRIPTION AND LOCATION	BOOK VALUE	ASSESSED VALUE	AMOUNT OF ENCUMBRANCE	TO WHOM

Insurance: On Merchandise_____ For Employers' Liability_____

On Buildings_____ Is any Insurance assigned?_____

On Furniture and Equipment_____ If so, to whom?_____

Do you pledge or sell accounts or notes owed you by customers to banks or finance companies or others?_____ If so, what amount is pledged?_____

Are any of your creditors secured by mortgage or other lien?_____ If so, how?_____ Amount?_____ Who?_____

Average Monthly Sales_____ Portion in Cash_____ Portion on Credit_____

Average Monthly Expense_____ If your business property is leased, for what term and rental?_____

Do you keep books of account?_____ If so, what books of account do you keep?_____

Are the above figures estimated or taken from books of account and inventory?_____

When did you take last inventory?_____ At cost or market?_____

Is any portion of merchandise shown in above assets on consignment or conditional sale?_____ If so, give details_____

Give exact location of business and how long established there_____

Previous business experience and where_____

PLEASE ANSWER ALL QUESTIONS. WHERE NO FIGURES ARE INSERTED, WRITE WORD NONE.

The foregoing statement has been carefully read (both the printed and written matter), and is in all respects complete, accurate and truthful. It discloses to you the true state of my (our) financial condition on the_____ day of_____ 19___ Since that time there has been no material unfavorable change in my (our) financial condition; and if any such change takes place I (we) will give you notice. Until such notice is given, you are to regard this as a continuing statement.

Firm (or Individual)_____

By_____ Member of Firm

Date of Signing Statement_____ Street_____ Town_____ State_____

IF PARTNERSHIP, NAME PARTNERS

Be sure to give a Complete List of Houses you deal with and Amount Owing each on reverse side of this sheet

(OVER)

BRENTANO LEDGER LEAF MFG. CO., EVANSVILLE 9405683

vailing conditions and demands of business, the most effective, and eminently the best way to prove his basis for credit, is to be willing to submit a statement of his financial condition.

5. *Value of references.*—When a business concern is given as a reference by a credit applicant it is practically certain that it is in a position to give him an excellent rating, while an individual not in business who is referred to may be presumed to be a personal friend. Such references would not have been given were it not known in advance that the information would be favorable.

This consideration discounts very materially the value of references given by the applicant, tho it would be unwise to conclude that it is too much bother to investigate them. Frequently they serve as valuable confirmation of facts gleaned elsewhere, and when they are of the nature of character references for a new concern or for an individual just starting in business they may provide information that cannot be had anywhere else.

Like every other source of information references must be carefully watched, for they are open to many abuses. The scheming dealer will often establish himself in the confidence of two or three well-known concerns and act the part of a first-class risk by discounting his bills, so that he may obtain a large quantity of goods on credit from another dealer. The firms with which he has maintained satisfactory relations can only tell of their experience and if the credit

man of some other firm is satisfied with this information alone, he may find out that he has the account of a "dead beat" on his hands.

6. *Commercial agencies.*—Practically every part of the business world is served thru branch offices of the two largest mercantile agencies—Dun and Bradstreet. These organizations collect and classify information about practically every person engaged in business in the United States and Canada as well as in many other countries.

In large centers of population each different trade is covered by a special investigator, while in territories outside of metropolitan districts the local reporter covers all lines of trade in the community where he is working. All rumors affecting the credit of a business are promptly investigated and the results of the inquiry reported to the nearest district office. Where territorial divisions are extensive and the visits of the investigator infrequent, local attorneys, retail merchants and postmasters are depended upon to keep the agencies informed of sudden changes which affect merchants in the district.

The information gathered in this way is distributed to subscribers to the agencies' service thru rating books which are revised quarterly, thru monthly or weekly information sheets and thru special reports. Rating books give the names and addresses of practically every business in the United States and Canada and show two ratings, the capital rating and the credit rating. The former is intended to show the

concern's net worth; while the latter indicates the relative credit grade and is based upon the past record of the house, its financial condition, the record of ledger experiences and its general standing.

It is not to be expected that the ratings given by the commercial agencies should be absolutely correct, since the information must be secured largely from the merchant himself; if he refuses it, the information must be obtained exclusively from other sources. Furthermore, approximately 4,000 changes in credit rating occur daily. The rating, however, as a source of preliminary information serves several useful purposes. It may, as a matter of policy, be used in compiling lists of prospects, and as a basis for passing upon very small sales or rush sample orders. Moreover a change in rating may suggest the need of revising the credit information.

In order to furnish credit reports, the agencies endeavor to secure a financial statement and to supplement this with information gathered from other sources. When requested by subscribers, detailed reports are prepared from this information; they describe the type of business, its history, the financial condition, paying habits, and usually quote trade experience, giving a hint as to the need for a credit limit. A sample report is analyzed in the chapter on "Analysis of Credit Information" in this volume. The minimum cost of Dun's or Bradstreet's mercantile agency service is $150. This includes two half yearly rating books and one hundred special reports.

Additional reports are furnished at a cost of 75 cents each, and quarterly rating books may be had for a moderate additional charge.

7. *Special credit agencies.*—Because of the widespread belief that more complete information could be acquired by an agency which covered a single line of industry several trades have established special agencies that work along the same general lines as those we have just been considering. As a rule, however, special trade agencies, in an effort to provide more specific information, make a finer division of capital and credit ratings than the general agencies. As examples of this type of agency, the following may be mentioned:

Iron and Steel Board of Trade—New York City.
National Jeweler's Board of Trade—New York City.
Manufacturing Jeweler's Board of Trade—Providence, R. I.
Lyon Furniture Mercantile Agency—New York City.
Leather Mercantile Agency—Boston.
Consolidated Building Trades Association—New York City.

8. *Credit information derived from salesmen.*—The value of the salesman as a credit reporter is dependent to a large degree on the relations which the credit office has established with him. There is a sort of traditional gulf between these two activities of business and it is only within recent years that any material degree of cooperation has been secured. While it is not practical to combine in one man the work of selling and credit granting, the gulf between

the two functions can be materially narrowed. A customer's weakness is frequently overlooked by the salesman because he is intent upon securing the order, and generally speaking a salesman's judgment on questions relating to the customer's desirability as a credit risk is insufficient unless supported by other information. This may be supplemented thru salesmen's reports but it is important to remember that a salesman should not be required to ask questions which might tend to embarrass his customer or himself. There is no objection, however, to using his services and developing his powers of observation in acquiring credit information. Experienced credit men are strongly opposed to involving the salesman in any duty for their departments, that would in any way lessen his usefulness as a salesman.

The following form has been successfully used in many concerns for a record of the salesman's observations:

Firm name..... ..... Address.....
Date..... ..... Salesman.....

In General

Business good? Growing? Competition?

In Particular

Store neat? Well located? Any advertising signs?
Stock kept in good order? Well displayed? Well stocked or low?
Clerks well trained or incompetent? Kept busy?
Proprietor a good business man? Social standing?
Drink? Gamble? Other firms bought from?
.....
.....

Altho a salesman's mission is primarily to sell goods and the loading of additional clerical labor upon him is extremely distasteful to him, there is nothing objectionable in asking him to use his eyes and ears while in the customer's store and secure what information he can about the merchant's character, volume of business and his business methods. Occasionally fellow salesmen, local merchants, the bank, or other persons may give him information. Sometimes such information may be significant but frequently it is colored or biased if not entirely unfounded. However, if the salesman forwards it to his house the credit department can usually check it up and ascertain the true condition. The salesman of course should not gossip about matters affecting a man's credit.

9. *Traveling credit reporters.*—The growth of wholesale business has made it difficult for the credit manager to visit customers except when unusual circumstances arose. For this reason concerns carrying a large number of accounts which frequently became doubtful risks, and who found it necessary to acquire a large amount of direct information, began to use the traveling credit reporter. Clearly, the latter has a delicate matter to handle. Unless he is of the right caliber and because of his experience is able to give constructive advice on merchandising, cost accounting, or storekeeping, his visit is likely to carry the suggestion that there is a question as to the soundness of the merchant's financial condition. The ex-

tent and character of the information obtained by the traveling credit man is shown by the following report.

.....BRANCH 19____

NOTE: Traveler must attach Merchant's Bill Head, Letter Head or Card.

No.....

Name of Firm .....

Address ..... Town..... State .....

(Street Address required in towns of 5000 or more population)

Full Name of Partners or owners. —If a corporation, position held (Pres., Sec'y., etc.)

Name..... Age..... Married?.....

Name..... Age..... Married?.....

Name..... Age..... Married?.....

Kind of business ..... How long in business at this location? ..... Successor to .....

Give former address if ever in business before .....

What kind of business?..... How long in that business?.....

From ..... to .....

Why did he discontinue? .....

If failed, what settlement was made with creditors? .....

If never before in business, what has been his occupation, and by whom employed?

.....

Does he give business his personal attention?.....Is his business growing?.....

Is he active?.....Is he attentive to business?.....Is he experienced?.....

What are local opinions as to his habits?.....

What do you consider are his chances for success?.....

What credit limit do you advise?.....

Value of real estate?.....Insured for $.....

Mortgage on real estate $.....Net value of real estate $.....

In whose name is title to real estate held?.....

Value of stock $.....Insured for $.....

Value of fixtures $.....Insured for $.....

Chattel mortgage $.....No. of clerks?.....No. of wagons?.....

Monthly sales $.....Monthly expenses (including Rent) $.....

Sell for cash or on credit?.....Appearance of stock and store?.....

Character of neighborhood, viz., poor, medium, or high-class?.....

Competition keen?.....How many chain-stores in vicinity?.....

Banks with .....

Give References and your Personal Opinion on other side of this sheet.

10. *Ledger information.*—One of the most useful sources of information and one that has been developed largely within the past few years is the exchange of ledger information. There is no source of positive facts so useful as the ledgers of concerns with which the prospect has done business, and in recent years this information has become more and more available. This variety of information is mentioned here for completeness but as it is directly in-

volved in the subject of credit cooperation it will be treated fully in the next chapter.

11. *Reports from attorneys.*—Attorneys who specialize in commercial business are usually in a position to render valuable service to the credit man. Thru their training and close contact with the business in their locality, they are qualified to judge local business conditions accurately and they may furnish information without violating any confidence on account of their relation to the community. There have been a number of attorney directories published, classifying by cities and towns the names and addresses of attorneys seeking commercial business. For listing in these directories the attorney pays a fee to the publisher, the amount of which is dependent upon the size and importance of the locality in which he operates. It is the custom of the publishers of such directories or lists to guarantee prompt payment of all money collected on claims sent to these attorneys.

Some of these lists provide report blanks for the use of subscribers to whom they are sold at approximately ten cents each with the understanding that there is to be no charge for the report in communities of less than 200,000 and a nominal charge in cities of larger population. In return it is understood that the attorney who provides the information furnished in the report is to receive whatever collection business the forwarder may have in his locality. The free system has been greatly abused and many attorneys have refused to furnish reports on this basis. Where

information is given in a free report, it is not so carefully prepared as information that is given in a paid report, for which the charge is usually $1. There is a difference of opinion among credit grantors as to the value of attorney reports. Some credit men use them extensively while others only occasionally find them worth while. In order to get the best results from this service the credit man should ask specific questions and accompany his inquiry with information which will help the attorney in making the investigation.

12. *Bankers' reports.*—As a rule local banks are willing to cooperate with the mercantile credit man. The bank seeks information from and is willing to give it to the mercantile credit department but of course the bank must be discreet and it can not violate its customers' confidences. Credit men are inclined to discount the value of the reports of some banks because the information given is too general and indefinite. Under such circumstances the credit man may seek the information thru a bank other than that in which the debtor carries his account. When an inquiry is made of a bank specific information should be requested.

REVIEW

Enumerate the sources of credit information.

Has the debtor any valid reason for refusing to furnish a financial statement?

Is the use of references primary or subsidiary?

Describe the service of the commercial agencies, general and special.

CHAPTER VIII

COOPERATION IN CREDIT GRANTING

1. *Importance of cooperation among credit grantors.*—To the credit man experience has emphasized how indispensable a part of credit practice is the free interchange of credit information, one credit man giving to another all the information he possesses about any customer, including the experiences his house has had with the customer. Those most experienced in handling credit data fully appreciate the value of the results that can and should be accomplished thru a free interchange of experience.

The work of the credit man is constructive rather than destructive. By some the belief is held that it is his duty to keep a person with a poor record from securing goods on credit; whereas, in fact, the chief object of his existence is, while promoting sales, to protect his own concern from loss, and if a bad account has been accepted, to collect the money due and yet retain the good-will of the customer. Thru cooperation, credit men are able to educate customers who do not meet their obligations promptly to the point where they realize that, if they intend to stay in business and secure merchandise for resale, they must play the game squarely and meet their obligations on time.

The credit man who refuses to cooperate by furnishing the fullest possible report upon any customer when such information is requested retards progress toward a highly desirable end, while he also misses a chance to strengthen a service of which he may at a later date find pressing need to avail himself. The fullest cooperation is possible only when every eligible business is included in the membership of the local credit men's association, and when every one becomes a member not alone for the information he can get but for the information he can give. The work of organizations of this kind will do more to prevent a poor risk from securing credit accommodations than all of the laws that are framed by our legislatures.

All over the country credit men are getting together for their own protection. Old jealousies are being eliminated and the "help-one-another" spirit is apparent in the meetings at which experiences are exchanged and by means of which those engaged in granting credit are being educated in the modern methods. In retail trade a man's ability to pay is as important as in the wholesale trade, yet the retailer has suffered most from poor credit methods. In the hard school of experience he has learned that clothes do not make the man and that ownership of property or social standing does not always imply honesty and integrity. Merchants now realize that it is a mistaken business practice to keep their losses to themselves, permitting the poor credit risk to prey upon others.

The realization by credit men themselves that losses could be kept down by closer cooperation has resulted in the practice of exchanging ledger information as orders come in. Out of this practice in turn has come the establishment of the Central Bureau for furnishing ledger experiences to members.

2. *Exchanging ledger information.*—When the practice of exchanging experiences was first started, merchants did not take kindly to the idea. They felt that they were disclosing secrets of their business which would enable their competitors to take away at least a portion of their trade. Gradually, however, this system of acquiring credit data has grown in favor.

The experienced credit man values very highly this record of the merchant's purchases and payments as well as the degree of confidence he enjoys. An unusual number of first purchases attracts the credit man's attention. While it may be thoroly warranted by the circumstances, it may disclose an unwholesome activity or the attempt to open new accounts because of loss of standing with old creditors. Inability to pay promptly is obviously a symptom of weakness and the analyst will consider it necessary to inquire into its extent and the seriousness of the cause. A credit man will frequently gather ledger experiences to test financial statements and also from time to time, between statement dates, to learn how the customer's credit standing is being maintained. The attitude of creditors generally towards a customer is a potent factor. Where confidence is lacking it may

We give below OUR EXPERIENCE with

Name..... Business .....
P. O. .....
From whom we have.....order for $.....
(Indicate whether first order)

ALL INFORMATION WILL BE CONSIDERED STRICTLY CONFIDENTIAL

Yours truly,

APPROVED AND ADOPTED BY
NATIONAL ASSOCIATION OF CREDIT MEN

To .....
.....

	MANNER OF PAYMENT ANSWER—YES OR NO	
Sold Since..... To		
Terms	.....	Discounts
Highest amount sold recently $....	.....	Prompt and satisfactory
Total amount now owing, $.....	.....	Slow but collectible
Amount past due, $.....	.....	Slow and unsatisfactory
Other information	.....	Days slow
.....	.....	Accepts C. O. D.'s promptly
.....	.....	Account Secured
.....	.....	Notes secured
.....	.....	Notes paid at maturity
.....	.....	Makes unjust claims
.....	.....	Collected by attorney

RETAIN THIS FOR YOUR FILES

Give your experience on attached slip

appear that the debtor will be closely pressed for payments, his credit drastically limited, and his buying market narrowed, crippling his operations and at times proving disastrous. Informative as ledger experiences ordinarily are, they may at times be misleading. A weakened condition may be concealed because payments are made promptly altho the funds may have been raised by making sales at a serious sacrifice or by borrowing secretly, and very likely by pledging valuable assets as collateral for the loan.

On the other hand being slow pay does not necessarily mean that the risk is a poor one. To gauge the significance of ledger experiences it is essential that the credit man be informed respecting the customer's character, antecedents, business operations, and financial statement.

The value of this system depends upon the completeness of the information provided and upon the number of concerns consulted. The form reproduced on page 140, is used.

The attached slip is in its essential parts a duplicate differing only in the first line which reads "Kindly give us below YOUR EXPERIENCE with," and in the last line which in bold letters reads "RETURN THIS TO US." The reverse of the form illustrated is used to explain the obligations of the maker and receiver of an inquiry in the interchange of credit information. The inquiring credit man is cautioned against indiscriminate inquiries; he should be reasonably sure that the person asked has information, to make no inquiries unless on an order in hand or a ledger account, to give a reason for his inquiry and to state fully his experience with the account. On the other hand those to whom the inquiry is addressed are requested to give exact experience, to have the inquiry answered by a responsible person and to inform the inquirer whenever he has failed to carry out his part under the interchange system.

Where credit interchange is carried on between dealers without using a central bureau the system de-

mands absolute fairness and a willingness to furnish promptly any information that may be legitimately asked. One of the weaknesses of direct interchange of ledger experience is the impossibility of collecting by correspondence all the information needed. For example, if a credit man were to receive an order from a new customer and should attempt to procure the ledger experiences from twenty-five or thirty houses selling to that customer, the cost in time and postage would not be warranted, especially if the order were small. Should he make from ten to twenty such investigations each day, the cost of operating the credit department would assume alarming proportions. Some better way of interchanging ledger experiences was urgently needed, and from the need have grown such organizations as the Interchange Bureau of the National Association of Credit Men.

3. *Operating thru a central bureau.*—In furnishing a comprehensive system of interchange of credit information the central bureau plays an important rôle. This can readily be appreciated by a consideration of the procedure followed in the credit interchange bureaus of the National Association of Credit Men.

The first step is for each member subscribing to a Credit Men's Association office to file a complete list of active customers. A card is then made out in the office of the Association for each of the accounts reported and filed alphabetically. Upon each of these cards is entered the numbers of all houses selling to the dealer named.

When an inquiry is received, the clerk who refers to the file can determine at a glance what members are interested in this particular dealer. He knows, therefore where information about the customer may be had and he likewise knows which cooperating members in the local market will be interested in learning of any change, favorable or unfavorable, that may occur in this particular customer's condition.

A form is then prepared and sent to each interested member who has only to insert his experience and return the form to the bureau as promptly as possible. This enables the office to clear the local markets in a limited number of hours and to furnish the inquiring member with a complete tabulated report of experiences gathered from various houses interested, so that he can pass intelligently upon pending orders or decide the course to pursue in the handling of a current account.

At the same time that local requests for information are answered, each office sends directly to all participating bureaus in the natural zone of purchasing interest of the person or firm inquired about, all that it has been able to learn about the subject. In this way, each office is in some degree a central clearance bureau.

When the investigation is started, an inquiry is referred to the Central Credit Interchange Bureau at St. Louis, Missouri. This bureau is thus centrally located to serve all markets by keeping a record of all bureaus which are interested in a dealer's account

outside of his natural purchasing zone. The central office immediately notifies such interested offices and they in turn obtain what information is available and forward it to the office of the association that started the original inquiry.

The Central Credit Interchange Bureau is not an office for tabulating reports; its function is to carry records of different markets which may be interested in persons about whom inquiries are made. The fact that information is sent direct to the office of which the inquiring house is a member, materially reduces time and effort in completing the investigation. The value of this plan is dependent upon the extent to which it is participated in by concerns selling the same class of trade. The greater the number of sources of ledger experience, the greater will be the degree of accuracy in judging the right of an applicant to receive credit.

4. *Foreign credit interchange bureau.*—The most recent development of the National Association of Credit Men has been the establishment of a bureau for the interchange of the experiences of American exporting firms with debtors in foreign lands. Already the bureau has reached a front rank position among the sources for foreign credit information and there is no doubt that it is destined to play a part of constantly increasing importance in foreign commerce. The best indication of this is that at the present time the bureau has a total membership of over 400, embracing practically

all of the largest manufacturers of exported merchandise in the United States. The bureau is cooperative and is not maintained for profit. It is under the supervision of a committee of its own members and is supported entirely by their subscription fees.

The purpose of the bureau is to act as a clearing house for a vast amount of foreign credit information which heretofore has been buried in the files of exporters in the United States. The characteristics of this information are very different from those of the report of a mercantile agency. The information is of most recent date and old or obsolete data are not used. The terms of sale extended by other American exporters to a particular account are indicated. This enables the prospective exporter to determine whether his customer expects or is requesting usual terms when longer periods of credit than are customary in domestic business are asked for. The information secured thru the bureau will enable the foreign credit manager to arrange terms on a par with those of other exporters.

The reports of the bureau show the amount of the credit applicant's outstanding indebtedness, including uncollected drafts. Any tendency to over-buy can be easily detected. The methods of payment of foreign customers are shown in the report, and with this information the credit man may determine the payment characteristics of the prospective buyer. Whenever information on a foreign credit applicant is furnished by a member of the bureau, he receives auto-

matically a complete copy of the entire report. This brings the information in his own files up to date without any great effort on his part.

In order to eliminate the unscrupulous foreign merchant, subscribers to the bureau send in the names of their undesirable customers. These are investigated and each subscriber is supplied with a copy of the report upon request. This plan has proved very effective in thwarting the foreign commercial crook. Twice a month the bureau publishes a confidential bulletin on general economic and credit conditions throughout the world.

The fee of the bureau has been fixed at $125 for the first year and $100 for each succeeding year. This covers one hundred reports on inquiries and the free reciprocal service just outlined. An additional one hundred reports may be obtained upon payment of $75.

5. *The National Association of Credit Men.*— Among the factors that cooperate in promoting sound, efficient and honorable principles in the conduct of American business, particularly in the department of credit, a prominent place must in fairness be accorded the National Association of Credit Men. Organized in 1896 at Toledo, Ohio, this association was a direct outcome of the deliberations held at the World's Mercantile Congress, conducted under the auspices of the Chicago World's Fair in June, 1893.

From a membership of 600 in 1896 it had grown to well over 30,000 in the year 1926, and had become a

business force of the first magnitude. It has many local branches, the largest of which boasts a membership of 3,000 or as many as the whole association in 1900.

The aims of the organization are stated very fully in its constitution. Among the more prominent are the following:

1. The organization of individual credit men and of associations of credit men into one central body.
2. A more uniform and firmer basis for granting credit in every branch of commercial enterprise.
3. Reforms in the laws that are unfavorable to honest debtors and creditors.
4. Adoption of new laws beneficial to commerce.
5. Improvement in the methods of gathering and disseminating credit information.
6. Amending business customs for the benefit of all commercial interests.
7. Providing a fund for the protection of members against injustice and fraud.

At the annual meetings of the association, subjects pertaining to the education of business men, not only in the department of credit but also in other branches of commercial activity are freely discussed. The local branch associations hold monthly meetings for similar discussions and several of them have monthly educational meetings. As an educational center for credit men, the association is doing good work, not only by means of liberal distribution of instructive literature, but—and especially—by its efforts to establish, under the direction of capable instructors, classes

for the study of sound credit principles and approved credit practice.

The activity of the association in securing the passage of legislation, both Federal and State, designed to protect the rights of creditors has been extensive and fruitful. It has taken an active part in the promotion and defence of national bankruptcy legislation.

It has had an honorable share in promoting state legislation in varied measures such as:

False statement acts
Secret assignment of accounts receivable
Bulk sales acts
Fictitious name law
Filing chattel mortgages
Bad check acts
Conditional sales acts
Landlord's lien acts

6. *Association ethics.*—Not without pride does the Association consider itself "a builder of conscience and commerce." It realizes that legislation, however minute, cannot be effective unless it is reinforced by standards of right conduct and it is therefore concerned in building up a code of commercial ethics. In one of its publications the Association says:

> In the rapid changes of economic relations of today, while the individual can claim much in the way of individual rights, other members of society can claim even more of him. Ethics and business are intermingling to the great improvement of each.

This may be regarded as the fundamental idea which led the Association to establish a permanent

committee on commercial ethics. The spirit in which the organization is working can be appreciated from one of the "sixteen canons" which it has announced. It reads as follows:

> In times of trouble the unfortunate business man has a right to appeal to his fellow business-men for advice and assistance. Selfish interest must be subordinated in such cases and all must give their cooperation and help. If the debtor's assets are to be administered, all creditors must join in cooperating. To fail in such a case is to fall below the best standards of commercial and association ethics.

7. *Credit men's organization in Canada.*—The credit men of Canada are united in a general organization known as the Canadian Credit Men's Trust Associations, Limited. The headquarters of this association are at Winnipeg, and branch organizations have been established at important points thruout the Dominion. The objects of the Canadian organization are identical with the association in the United States and many of the same methods are employed. Because of the intimate community of interest between credit men in the United States and Canada, the associations of the two countries have close relations.

8. *Retail Credit Men's National Association.*—Occupying in the retail field a position corresponding to that held in the wholesale field by the national credit men's association is the newer but no less active Retail Credit Men's National Association. It has grown and developed in response to the need for a permanent organization to improve retail credit conditions.

Its objects are much the same as those of the older association: to promote the education of retailers and their customers to the better understanding and appreciation of good credit relations; the exchange of information and experience among retailers; to promote uniformity of retail credit and collection policy and practice, and to seek for consistent improvement of the laws dealing with individual credit seekers and the enactment of new laws for the benefit of retail grantors.

The official organ and mouthpiece of the retail credit men is the monthly magazine called the *Credit World,* which circulates widely among local associations all over the country and which serves as a very helpful medium for the exchange of much beneficial information and experience.

REVIEW

What is the underlying idea of the exchange of ledger experience? Explain how this is operated thru a local association. How has it been extended thru the central bureau maintained by the National Association of Credit Men? How has it been applied to foreign trade?

Describe the activities of the National Association of Credit Men.

CHAPTER IX

ANALYSIS OF CREDIT INFORMATION

1. *Measuring credit information.*—From the facts that have been brought out in foregoing chapters it is clear that one of the chief functions of the credit department is to gather from all the possible sources information bearing upon the credit customer, his character, his habits, his means, his manner of doing business and the actual condition of the business itself. Of this information by far the most important is the last item, the condition of the business as shown by the customer's signed financial statement.

Of even greater importance in the final outcome, however, is the credit department's responsibility for measuring and weighing that information from all angles, and judging whether it is safe to open an account with the applicant, or to continue to do business with him if he is already on the company's books as a credit customer.

2. *Importance of financial statements.*—A reference in an earlier section included a warning against putting too great reliance in the personal statements of credit applicants. It remains now to show the value of such data when recorded in proper form and protected by proper safeguards. Because the finan-

cial statement commonly required of the credit applicant offers in a standard form a current history of his business, from which anyone may read the story of his accomplishment, it naturally takes first place in order of importance as a basis for approving or continuing credit relations.

If an applicant is to be judged on his character, capacity and capital, the property statement reflects directly the capital item, and indirectly the capacity item. Contrary to the conception popularly held of such a statement, it does not in itself create credit but merely settles the question of "how much." Very often this is the most important question. Small credits may be granted without very much consideration, especially if there is the additional inducement of opening a profitable new account, or of beginning business in a special line of goods. If, on the other hand, the accommodation asked for is large its granting must be based on abundant and accurate information. After the credit grantor has satisfied himself that the applicant is honest and sensible, and has a reasonable capacity for the business he is in, the credit problem always comes down to a consideration of exact information which ought to be reflected in a properly constructed financial statement of his business.

3. *Value of direct statements.*—By far the greater number of financial statements come thru the commercial agencies. To the value of these we have already referred, but it must be remembered that they

are frequently too incomplete or out of date to be used as a basis upon which an intelligent answer to the question "how much" can be founded.

Where the merchant is called upon to fill out a carefully prepared form furnished by the concern from which he wants to secure credit, greater pains will be exercised in compiling it. When a creditor obtains written financial statements at regular intervals directly from the debtors already on his books it exercises a salutary moral influence on the debtors. In the first place, a debtor realizes that his credit standing will be influenced materially by the kind of a statement he presents. Presuming that he possesses the other qualifications of a good credit risk, he will, therefore, keep his business assets in as good condition as possible, so as to be able to present a favorable statement. A man disposed to speculation will stop to think of the effect on the appearance of his balance sheet before he enters upon a hazardous undertaking.

Another powerful reason for demanding financial statements is the fact that thru their use dishonest debtors are deterred from committing frauds. In a number of States there have been enacted false statement laws which make it a crime for a merchant to present an untrue statement in writing for the purpose of securing credit. In addition to the state laws making the issuance of false statements for the purpose of obtaining credit a crime, there are federal statutes under which debtors who have secured mer-

chandise on credit by mailing false financial statements may be successfully prosecuted.

4. *A standard form of financial statement.*—There are numberless different styles and forms of financial statements in use, but those designed and recommended by the National Association of Credit Men are becoming standard. We have already considered the most popular of these forms, that reproduced on page 127. This form is so designed that when folded for mailing it is self-inclosing and needs no envelope. The postmark on the statement itself is valuable evidence if it ever becomes necessary to prove in court that the person who made out the statement had used the United States mails to defraud.

Credit men generally require the house submitting the statement to divide the accounts receivable into those due, not due, past due, and doubtful. If the credit analyst finds the firm maintaining a reserve for bad debts that seems adequate, no deduction is made; otherwise, he adjusts the amount to conform with conservative practice. Notes receivable are divided into originals and renewals. Original notes are taken at full value, while renewals are adjusted according to the number of times they have been renewed.

All items on a statement are useful as an index to the efficiency of the management. The affairs of a business as a going concern being in flux, all items affecting the profit and loss account have a strong direct bearing upon the amount of the net proceeds from quick assets which will be available for debt

paying and must be carefully considered in connection with a study of the quick assets and quick liabilities when considering the question, "if we sell this man will we get our money promptly?"

5. *"Quick" assets and "quick" liabilities.*—The question often arises, what is a quick asset? Definition here presents some difficulty, yet the most general statement is also the most truthful. A quick asset is something belonging to a business which can be quickly converted into money. If a man has ten barrels of sugar in his basement that is a quick asset; if pressed for cash he can sell the sugar within a few hours time. A sacrifice price will always produce a market for it. On the other hand a man's store fixtures could not be so easily sold; in fact it might take several months to find a buyer. Consequently, store fixtures are fixed assets which only in an emergency would be turned into cash and then, probably, only at a considerable loss.

According to the practice advocated by the National Association of Credit Men the quick assets which should be given first consideration in analyzing a financial statement are as follows: 1. Cash in hand—cash in bank; 2. Good accounts receivable; 3. Stock on hand at actual value.

Similarly a "quick" liability is an obligation which is due or must be met in the near future. According to the established practice the quick liabilities of a business are: 1. Amount owed on merchandise due—amount owed for merchandise past due; 2. Amount

owed for notes payable, unsecured; 3. Due individuals for borrowed money; 4. Due bankers for borrowed money.

The answer to the question, "Have you endorsed the notes of others?" naturally has a very direct bearing on the financial condition of the business.

6. *Separating the doubtful items.*—Taking the foregoing items one at a time, cash in hand represents receipts not yet deposited in the bank at the time the statement was made, that is, cash kept on hand for paying small items of daily operating expense. Cash in bank obviously covers the actual bank balance as shown by the firm's check book. A small amount of cash where the volume of sales is large and where accounts and bills payable are correspondingly heavy means that the merchant is courting danger.

Accounts receivable covers amounts due the firm on open accounts from its customers. Not all such accounts, however, are quick, which explains why this item for the purposes of the credit man is qualified by the word "good." There are always accounts in every business the collectability of which is questionable; some are worthless. The doubtful account, as has been suggested, must be deducted and considered separately. If the statement makes no such division of accounts it is well to question the applicant on this point, or else to write off such a percentage of the accounts receivable as to make a reasonable allowance. This percentage of bad debts will vary with different lines of business as well as with the business

sense of the applicant in opening and following up his accounts. Accounts receivable should, in common with merchandise, be considered in its relation to the amount of annual sales as well as to the credit terms which obtain in the trade. If the proportion of accounts receivable to annual sales is unduly large it may imply a lax collection policy or reveal incorrect accounting methods regarding the loans to partners or officials discussed in the next section.

7. *Padded financial statements.*—Sometimes financial statements appear more favorable for the applicant than the facts of the business warrant because loans to partners or corporation officers are included under the heading bills receivable. In such cases the asset is not always quick; it often happens that such partners or officers are unable to repay the loans on demand in case of a forced liquidation of the business. For this reason any such loans should be shown separately.

Another matter that must be carefully ascertained is whether or not the item, accounts receivable, represents merchandise which has actually been sold and delivered.

Notes receivable are assumed to be those made by financially responsible persons or corporations. This item should not include notes that are in any way questionable. If an applicant is holding notes of any considerable amount and his statement shows a shortage of cash, it is quite in order to inquire guardedly as to the worth of these notes. Banks will ordinarily

advance money on notes of good signature, and a business man who obviously needs cash usually discounts such notes to get it. The fact that he is holding them while short of ready cash looks suspicious. Two questions naturally arise. Couldn't he get anybody to take them off his hands? What is the matter with the notes?

8. *Importance of date of inventory.*—Stock on hand is naturally a very important item in every mercantile financial statement, and one that will stand the closest scrutiny. The time the inventory is taken is important in judging the relative proportions of the items in the statement. If the "stock on hand" is not based on a recent and accurate inventory it has practically no value from the credit man's point of view. If the amount is merely estimated, or if it is based upon an old inventory it is guesswork.

The practice advocated by the National Association of Credit Men is that all stock must be shown at actual value. Actual value is not always determined by what the merchant has actually paid for his goods, nor is it what he thinks they are worth. Merchandise should be valued at actual cost only when it is fresh and salable and when the cost is below the prevailing market price. If it is shelf-worn or out-of-date or the prevailing market price falls below cost its value should be discounted accordingly.

9. *Value of audited statements.*—The audit of the books of a credit applicant by a firm of reputable accountants is highly desirable. Such accountants

will not countenance flagrant misrepresentation of value and they will not indorse any estimates or methods which are not in accordance with a fair standard of ethics. As is set forth more fully in the Text on "Financial and Business Statements," the certificate of an auditor should be carefully noted. Cases are known where auditors have seen fit to certify that "the statement is in agreement with the books," which merely indicates that the figures have been correctly compiled from the ledgers but not whether assets are correctly valued or all liabilities appear on the books. The certificate should clearly show that complete examination has been made and that the statement faithfully reflects all conditions. Qualifications to the auditor's certificate should be carefully scrutinized.

10. *Other questions to be raised.*—In addition to the regular questions covering the various items of assets and liabilities, a statement form should also call for certain special data. Some of these points are as follows:

Amounts due by officers, stockholders or sales agents.
Amounts due to or by subsidiary or controlled companies, or by members of the firm.
Amount of assets pledged as collateral.
Amount of contingent liabilities.
In the liability column the amount secured by collateral, judgment note, or otherwise should be specified.
Annual volume of sales.
Losses by bad debts.
Total amount of expenses.
Annual dividends, or amount withdrawn by partners.
Net profit.

Amount charged off for depreciation to plant and machinery.
Amount of fire insurance.
Bank accounts.
Amount of purchases contracted for but not yet delivered.
Are books audited: if so, by whom and on what date?

11. *Convertibility of assets.*—After analyzing the statement in the light of the suggestions made, some credit men, as an extra precaution, allow for a shrinkage of merchandise and accounts receivable by arbitrary proportions and write off as dead assets such items as store and office furniture and fixtures. This extra precaution gives what the banker calls a "factor of safety" and it is based on the well known truth that "assets shrink but liabilities never."

It is a matter of common observation that merchandise is convertible into cash in direct proportion to its nearness to a state of raw material. It is much easier for example, to turn wool or iron into money than it is to do so with clothing or hardware. The explanation is that since manufactured goods are in a special and narrower class than the raw material from which they were made, their utility is restricted, and hence their sale is effected with greater difficulty.

The particular kind of business in which the dealer is engaged will have an important bearing on the credit granted. No credit man looks for the ultimate collection of his debt thru legal processes; neverthe-

less he remembers that in certain lines of business the assets can be converted into cash on a forced sale with less loss than in others.

12. *Can more definite rules be given?*—However important the foregoing considerations it must be admitted that they are somewhat vague and indefinite. Some progress has been made in reducing them to mathematical terms and in devising formulas which when applied to statements will aid in discovering points of strength and weakness. The Robert Morris Associates, an association of bank credit men, have collected data with regard to basic industry to show typical ratios and variations. The practice among credit men of applying such ratios, as they are worked out, seems to be spreading. It is based on principles which are eminently sound but no ratio or other mathematical formula can be used as the final arbiter in credit granting. Each case must be analyzed on its merits.

13. *Business types.*—In a statement on this subject prepared for the Federal Reserve Board, under the supervision of the Division of Analysis and Research, Mr. Wall says in effect that financial statements are neither all alike nor all different. The common empirical rules for their interpretation are based upon the idea either expressed or unexpressed that they are all alike. If the contrary were to be assumed there could be no rules whatever. It would be a case of forming an opinion on many given situations without knowing just why it was done; a pro-

cedure which outside of business operations would be called blind chance. Of course, the truth is that certain groups of financial statements are alike. There is every reason to suppose that there is a family resemblance between grocers' statements, but one would not expect a like similarity between their statements and those of dealers in drugs or dry goods or hardware or shoes. A composite picture of all statements would give a very hazy and uncertain outline. A composite picture of all statements of one class would in all probability reveal a definite type.

14. *Typical statements.*—Mr. Wall's conclusion was that if there was in each line a typical business, there must be also a typical business statement. Proceding on this belief he has collected from various sources a large number of statements in several lines of business and has studied their characteristics.

From this study he has evolved a typical statement of each line. This statement is expressed in the form of a ratio. The starting point is the well known ratio between current or quick liabilities and current or quick assets. The statement is often made that when quick assets are double the quick liabilities, the credit risk is safe, but this is not to be taken as a complete test of the financial condition. Mr. Wall in his analysis goes further and establishes other ratios, his "seven point" scheme requiring the following:

1. Current liabilities and current assets.
2. Receivables and merchandise.
3. Worth and fixed assets.

4. Debt and worth.
5. Sales and receivables.
6. Sales and inventories.
7. Sales and worth.

In the foregoing the term "worth" has been used to indicate the total of capital, surplus and undivided profit. Otherwise the terms are self-explanatory.

In the study of the statement he establishes the normal ratio and also the range from which such ratios are computed. Having established a normal and what might be designated as the range of permissible deviation, he is able to test any individual statement which may be presented for consideration. Any marked departure from safe business will reveal itself in one if not in more of the ratios which have been established. Thus it would be a danger signal to the credit man, and while extraordinary circumstances might warrant the granting of the credit, it would, at least, put the credit man on his guard and show him the need for further investigation.

15. *Varying considerations.*—The same procedure adopted for one line of business, for example, groceries was adopted for other lines, dry goods, hardware, and the like. In each of these, the typical set of ratios was developed and the permissible variation which may exist without impairing sound business conditions was established. These ratios are never alike thruout for two different lines of business, tho they may be practically identical in one or more particulars.

The studies which Mr. Wall has made have demonstrated that the old rule that current assets must be double the current liabilities is an unsafe guide in granting credit in some business lines. In certain instances, the ratio may be considerably more than double, and in other lines there is a possibility that it may be slightly less. Further study of the typical figures will serve to reveal more and more the significance of the less familiar ratios.

The objection which has sometimes been made to the seven-point analysis of Mr. Wall is that it is cumbersome, but this criticism may be met by the fact that the calculations required to ascertain the ratios can be made very quickly by the logarithmic method, or if a memorandum of calculation is not deemed necessary, they can be rapidly computed by the use of the slide rule.

16. *The effect on credit information.*—There can be little doubt that as the plan here suggested comes into wider use it will bring with it further information to the credit man. In another chapter, it has been shown how important is the matter of turnover, which is Mr. Wall's sixth point. He has found in the course of his researches considerable difficulty arising from the fact that applicants seem reluctant to report the amount of annual sales. Altho this is not a vital part of his scheme, it is essential to a clear understanding of the financial position of the house requesting credit. With the need which a further analysis will no doubt develop, other particulars,

which at the present time have no place in the customary financial statement, will probably be required by the future credit men.

17. *Analysis of agency reports.*—As was stated earlier, by far the greater number of financial statements on which credit applicants are judged come thru the commercial agencies. It is in order then to examine a typical credit report, of the kind that comes to the credit man's desk in the ordinary course of business, in the light of the three determining factors—the applicant's capacity, capital and character.

The following is an actual commercial agency report on a manufacturing concern in which names and places have been disguised for obvious reasons and which will serve to illustrate some of the considerations to be weighed in passing on credit asked for. It may be noted that in the balance sheet included in this report the quick assets are not listed first as is considered the best practice.

Fleming & Barnes, Mfrs. Laundry Machinery, Flint, Mich.
110 State Street.

George F. Fleming, age 52, married.
Vincent C. Barnes, age 50, married.

November 15, 19

This partnership was formed in January, 1902. Fleming had previously been in business at La Salle, Illinois, where he had a small iron foundry. Barnes had been a traveling salesman selling a general line of laundry machinery. At the start Fleming claimed to have put $5,000 into the business in cash, Barnes contributing $1,000 together with cer-

tain patents. The partnership agreement provided that they were to share alike in the profits. The business grew rapidly from its inception, but no additional capital has been put in, and they have always been more or less pressed for ready funds. In 1915 they were compelled to ask an extension from their creditors, getting out of their difficulties at that time by giving six months notes, most of which were met at maturity, and the balance ran 30 to 60 days over.

STATEMENTS

DATE	ASSETS	LIABILITIES	NET WORTH
July 1, 1916....	$124,682.00	$106,568.00	$18,114.00
July 1, 1917....	181,684.32	144,348.00	47,336.32
Nov. 1, 1918....	196,432.68	155,907.05	40,525.63
Nov. 1, 1919....	220,500.00	179,432.56	41,067.44

Under date of November 12th the following signed statement is received, purporting to show condition of the business on November 1, 1920:

ASSETS

Machinery and Plant, including buildings....		$68,501.00
Stock on hand, raw and finished		65,681.56
Bills Receivable		18,700.00
Accounts Receivable		26,682.40
Cash on Hand and in Bank		2,560.00
Cash in hands of Eastern Agents		1,500.00
Stock on consignment with Eastern Agents..		13,300.00
Total		$196,924.96

LIABILITIES

For mdse. (Notes payable)..	$111,601.00	
Accounts Payable	35,500.00	
Owe to Bank	8,000.00	
Commissions payable	1,222.50	
Reserve for depreciation	4,200.00	$160,523.50
Surplus		$36,401.46

REAL ESTATE

In name of George F. Fleming		
Residence 226 N. Third St..	$11,500.00	
Mortgaged for	4,000.00	7,500.00
In name of V. C. Barnes		
Residence 251 N. Fourth St.	$10,000.00	
Mortgaged for	6,000.00	4,000.00
Total net worth		$47,901.46

Fully covered by insurance.

November 15, 19

General Information

It will be noted that statement shows a gain of $6,800 compared with previous figures. They have improved their position, showing a reduction in liabilities of $8,900, with a reduction in assets of $2,000. The liabilities are still very heavy, rendering their condition top-heavy. The buildings are erected on leased land, and it is believed that because of inadequate manufacturing facilities, their overhead is too high. The plant is well situated with regard to railroad facilities. The depreciation allowed on machinery and plant is considered too small but as an offset to this they state that they have charged off all patterns, moulds, and jigs.

Fleming and Barnes are both hard-working men, with a good knowledge of the business, and it is thought that with better management of finances the business could be placed on a better basis.

Payments

H. C.*	ORDER	OWE	DUE	
2,000	..	0	0	Sold for several years. Have always been slow.
200	..	200	200	Terms 2/10-60. 30 days slow.
610	..	0	0	Old account usually 60 days slow. Sometimes settle by note.

*Highest credit, i.e., largest amount extended.

50	..	0	0	Slow 30 days. Terms 2/10-30 days.
75	..	75	75	First transaction. August bill still unpaid.
3,000	..	2500	1200	Slow 60 days.
11,000	2000	5500	0	Terms 60 days. Invariably pay by note. Occasionally ask extension.
15,000	..	750	750	Old customer. Watch account closely.
7,500	800	1000	1000	Slow 4 months. Old account.

FIRE RECORD

Had small fire in foundry July, 1916. Loss $600 fully covered by insurance.

Applying the test of capacity, which may be divided into technical and financial, it will be noted at once that while the firm members are given credit for industry and good technical knowledge of the business, they are not very strong on financial ability. The statement shows that the business, in spite of its evident handicap from insufficient capital, has nevertheless made headway. The payment record indicates quite clearly that any credit allowance should be limited and closely watched.

Accepting all the figures as representing full values the total of the liquid assets is insufficient to meet the liabilities, indicating an extremely weak financial condition. This weakness appears to arise from a tendency to neglect the collection of accounts, as much as anything. This is indicated in the item of bills and accounts receivable, to offset accounts payable and owing to the bank. The fact that commis-

sions payable just about equal the amount of cash in the hands of eastern agents weakens their position accordingly.

Under character—the third "C"—we note that there is nothing said directly reflecting upon the members of the firm, except the fact that they lack something in the ability to manage their finances. On one occasion when they were obliged to ask their creditors for extensions they made good in their promises of payment. We know that the firm is slow in paying its bills.

To sum up, the firm is skating on thin ice financially, first because of faults in management, and second from need for more capital. Liquidation of the business would not guarantee creditors against loss. In the circumstances the firm's orders should be accepted only on a cash basis.

REVIEW

How do financial statements promote accuracy, insure caution and prevent fraud?

What are "quick" assets and liabilities and what is their importance for credit purposes?

What items of the statement must be closely scrutinized?

Outline the objections stated against the "current ratio" as a sole criterion of credit.

What might be put in its place?

CHAPTER X

THE CREDIT MAN

1. *How need of the credit man arose.*—It was not so many years ago that credit was dispensed by the proprietor of a business himself. Markets were just emerging from the neighborhood stage thru the agency of improved travel and shipment facilities. The proprietor had been accustomed to meet personally the merchant customers who paid their periodic visits to his place of business and in spite of the expanding market he maintained the old attitude just as fully as he could. In the course of this personal contact the proprietor was able to determine the quality of the credit risk thru his own observation and to determine the arrangement of payment terms.

The development of the country's industries brought with it new competition and a need for new and more aggressive methods of securing business. The widening markets made it impossible for dealers to make buying trips which would cover all the lines they needed to buy, and it became necessary for the manufacturers and jobbers to have salesmen travel over sections of the country never before reached in order that the seller's increased output of goods might be adequately marketed. No longer did the

proprietor come in personal contact with most of his customers.

For these and many other reasons, growing out of the expansion of business and the complexity of its transaction, the proprietor began to delegate part of the responsibility of passing on credit risks to his bookkeeper. For a time this employe was equal to the task. Later, however, with a still greater intensification of trade, it became necessary for the bookkeeper to be as well informed on the standing of a customer in Massachusetts or in Texas as of a customer doing business next door. Along with the need for dependable information concerning the credit worth of customers in far-off sections of the country there grew up agencies which made it their business to supply this service. With the multiplying of new sources of information and the pressure from competition to accept a greater volume of business on credit, it came to be more and more of an impossibility for the bookkeeper, with his own departmental responsibilities increasing in like proportion, to attend to the credit functions thrust upon him.

The natural result of this situation was the development of specialists in the checking of credit extended to customers. In every large business the need was felt for a man who could spend his time looking after accounts, both those already on the company's books, and those offering themselves for consideration and acceptance.

2. *Responsibility of the credit specialist.*—As mod-

ern business concerns use it, the title of credit manager includes a far wider scope and responsibility than the term itself defines. The credit man takes his station well up the scale on the financial staff of a business because of the nature of his work. Not infrequently he is found in responsible charge of the entire office work, with general oversight over the accounting and record keeping departments. Often he is functioning also as the treasurer or cashier in whose charge the handling of the funds of his concern is placed. In such cases he is the man who watches the bank balance, the bills payable and the accounts receivable, the merchandise turnover and the outstanding orders.

Constantly studying the affairs of credit applicants the credit man acquires a broad-gauged grasp of business principles and management and particularly of the requirements of sound financing.

The test of the credit man's success is the ratio of annual losses, due to bad accounts, to sales. Since the fundamental aim of all trade is to make a profit, this aim is attained by the stimulation of profitable sales thru the regular channels of industry. This part of a credit man's work, to engineer the progress of sales, altho of very great importance, is often not considered. If he were to confine himself simply to reducing losses, it would not be very difficult for him substantially to eliminate bad debts simply by declining to accept any but "gilt edge" risks. It fol-

lows, of course, that such a policy would lose a big volume of business for his house.

One authority in summarizing the tests to apply to a credit man's work goes a bit further when he makes the following points:

1. How much does he lose in bad debts?
2. How many prospective customers does he turn away from all future sales?
3. How much does he lose in orders rejected?
4. How many present customers does he offend or lose?
5. How much of the expense of sales and advertising efforts does he nullify?

3. *Special training needed for credit work.*—For his purely credit functions the man who administers the credit policy of the house needs first a wide and general knowledge of business principles and practice and of present business conditions.

In addition to this general knowledge of business practice the credit grantor should be familiar with the merchandising details of all the lines of business in which his customers are engaged so that he may determine whether the capital, sales, expenses, and past experience of the applicant give promise of his ultimate or continued success. In the interpretation of the credit statements laid before him for inspection he would be at great disadvantage if he had not a thoro knowledge of accounting, and the significance of the items in the statements.

A knowledge, at least elementary, of commercial law is a valuable equipment for credit work. The

credit man cannot be without a knowledge of the statutes of exemptions, the financial responsibility of corporation officers and of the members of a partnership, the legal age limits of open accounts and other data of like nature.

Above all, he must know the accounts of his concern. He should have accurate knowledge of the activity of each account, including the average amount of purchases made by the customer during different seasons of the year, the amount of indebtedness and the manner of making payments. This is all necessary if the credit man is to recognize uncommon activity or any unusual developments affecting an account.

In addition to his knowledge of production, marketing, law and accounting, the credit man requires considerable knowledge of financial subjects. Since he has more or less to do with banks he naturally should secure for himself a good working knowledge of banking practice so that he may know how the banks can be used to serve his interests most effectively.

Since capital is a commodity that is bought and sold much as are other goods for which there is a changing demand and since prices in general are affected by the rate of interest, it follows that the credit man should have some knowledge of the current financial situation, the work of the stock exchanges and the investment market. Some knowledge of insurance is most important when it comes to making

sure that the customer to whom credit is extended has himself properly covered against loss.

Last but not least the credit man should be a student of his own specialty, credit. This does not mean merely a familiarity with credit routine or method but a study of the subject broadly, in all its economic aspects.

4. *Personal attributes.*—Possessed of all the knowledge that makes for the training of a well equipped credit man, there are still many personal attributes—mental, moral and social—without which his work will be rendered difficult if not impossible of full success.

Take for example his need for keen insight and the intuitive faculty for quick and accurate judgment that goes with an analytical mind. The work at the credit desk requires day by day a succession of decisions, each one important, but necessarily made hastily. These judgments are not arbitrary; they are based on a study of certain groups of facts, usually of four kinds: the credit man's own knowledge, impressions gained by him thru personal touch and acquaintance with the customer, specific facts concerning his character, ability and resources, and if he is an old customer, his record with the house. The faculty which enables the credit man to fix at once upon the vital and decisive factors in this mass of material and to sift the significant facts from the chaff and then correlate them is obviously a part of his business equipment.

No less essential in the credit man's equipment are the priceless qualities of sympathy, imagination, and tact, for it is only thru these qualities that he can hope to get the information which he must have from his customers, and yet retain their good-will. Tact implies an openness to receive advice, a willingness to learn new facts and change old methods. It means sympathy with other people and the ability to put oneself in their place and understand their condition. No tactful man is impetuous; he weighs facts, but he can decide quickly and intuitively on the right course to take. A good memory is a necessary equipment, otherwise he cannot bear in mind people's weaknesses and their sensitive spots in order to avoid them.

Last but not least in importance, the credit man, by the nature of his relationship both with customers and with those associated with him in the business, must be a good deal of an optimist. It is this quality that will help him avoid the foolish error, formerly only too frequent among credit men and sharply limiting their usefulness, of thinking that men generally are dishonest.

5. *The nerve center of the business.*—The credit man should be among the first to recognize the necessity of cooperating in his administration of the credit department with every other department of the business. A spirit of democratic equality and interdependence, rather than an attitude of isolation or "go-it-alone" should characterize its work with the sales,

the production and accounting departments. In the very nature of things the credit department becomes the natural center for gathering and registering information of all kinds that may apply in any way to its customers or their business, to general conditions affecting sales policies or advertising, to complaints from customers on quality of product, method of packing or what-not affecting the manufacturing. It is not stretching the imagination very much, therefore, to say that the credit department in a well balanced organization performs many of the functions of a nerve center for the business, which receives and records impressions of all sorts and makes proper use of them for the best interests of the business.

6. *As a business adviser.*—The credit man who is not the best business friend and adviser of his concern's customers as well as its salesmen is not living up to his possibilities. Manufacturers and wholesalers recognize more and more clearly that the best way to promote their own business is to promote the business of their retail dealer customers. If they can make better merchants of such dealers so that they can sell more goods, they are making for themselves potentially large buyers and prompter payers of bills.

If a customer gets behind in his payments an analysis of the reason for this condition can be made by a study of his financial statement. If the customer is overstocked, suggestions can be made for moving the stock by proper sales campaigns; if too much money is outstanding, accounts can be realized on by sug-

gesting to the customer the methods of conducting a proper collection campaign.

Service of this kind, offering advice and suggestions which will help a customer to put his operations on the right side of the ledger, will not only enable him to pay his obligations to the house but will be more than repaid in future business from one who has profited by the advice.

REVIEW

What were the conditions in industry and trade that made the credit man a necessity for large concerns?

Describe his general place in the organization of a business. What are the tests of a successful credit man?

What training should a credit man possess and what personal characteristics are desirable for the best success?

Describe how the credit man may become a powerful factor in the development of the business and a helpful aid to its customers.

CHAPTER XI

CREDIT MANAGEMENT

1. *Essentials of organization.*—Back of the credit-granting authority there must be a "system"—an organization in the credit department of a business which is simple, accurate and as nearly as possible automatic in its operation. The building and maintaining of such a system for handling the routine of investigating, and checking orders is probably the most important thing the credit man has to do.

The character of the business as well as its size and the many local conditions that exert an influence upon it, will in a large measure determine the various details of such a system. The system for the credit office varies, even among organizations with similar problems to meet, and still more so among concerns which differ with respect to size, the number of accounts to be handled, the frequency with which purchases are made and the classes of customers who make them.

The ideal system is always the one that answers all requirements at the lowest operating expense. How it fits these requirements may be well tested in the results of a well handled sales or advertising campaign which brings down suddenly upon the credit department an influx of new accounts for which ad-

vance preparation must be made. A sudden change of marketing policy may put a strain on the credit machinery that will completely clog its working. It should be noted that while no system can function entirely independently of the personality of the man in charge of the credit department, there are elements common to all successful systems which can be taken as standard.

2. *Functions of the department.*—The functions of the credit and collection departments are (1) to pass on demands for credit and (2) to follow up for payments. For the purpose of fulfilling these functions every credit office must be equipped to handle data of two kinds: (1) outside information, which reaches it continuously thru agency reports, the interchange of credit experience with other dealers, customer's financial statements and the like and (2) inside information which is gathered from the customer's ledgers, correspondence files and the records of the house salesmen and collection files. One authority has listed the necessary operations that the successful credit office must perform:

1. Record or have access to a record of all charges and credits for each customer.
2. On new orders received, either pass for credit, hold for investigations or refuse.
3. Make out invoices—file duplicates.
4. Handle and file all correspondence relating to customer's accounts.

5. Regularly follow up accounts falling due and remaining unpaid.
6. Keep other departments advised of condition of customer's accounts or changes in credit ratings.
7. Receive notice of all payments made so that the collection follow-up may be adjusted accordingly.
8. Be kept informed of complaints or demands for adjustments affecting payments.

Thus the details of operation calling for credit reports, the early steps of the follow-up, a large part of the routine correspondence and the charging and crediting of accounts can be performed on standard schedules. Broadly speaking, the test of a good credit office system is that it provides, with the least delay and chance of error, the information desired, and that it guards against mistakes and omissions on the part of the credit man himself by warning him automatically of dangerous accounts and of weakening customers. It will be of interest to see how this is done in the case of an ordinary wholesale house. The method described will not, of course, fit equally well every kind and condition of business, but it should, nevertheless, be suggestive as to the essential points to be covered by such a system.

Usually, the credit man begins his business day by examining the contents of the morning's mail. From this source he obtains considerable information

with regard to the state of collections without having to consult the ledger accounts every day. He sees, for example, what customers are taking advantage of cash discounts, and knows at once when a draft has been returned by the bank, uncollected. He also sees the receipt of new orders without having to wait for the reports that are sent in by the sales department and by other departments. At the same time, he is kept in touch with the latest news concerning business conditions within the trade, complaints of customers and matters of a similar nature.

In admitting a new customer to the firm's ledger, the most important question concerns the credit standing of the newcomer. It is also important that the name and address be correctly recorded, and that a system be devised which permits all credit information relating to the new customer to be instantly available and so arranged as to serve as a guide for the credit man in passing upon subsequent orders from the same source.

3. *Requesting a signed statement.*—Frequently the information obtainable from outside sources is inadequate for the purpose of granting credit. Frequently, the information at hand is too old to represent accurately the credit-seeker's condition at the present moment. It may then be deemed necessary to obtain a signed financial statement from the credit-seeker before the credit department can check the order. It is important, of course, that a request of this nature be made as tactfully as possible, lest it

should offend the recipient and cause the loss of a profitable customer.

If, on receipt of such a letter, the customer ignores the request for a financial statement, it is safe to assume that he has ample reason for withholding the information. Particularly is this true if it has been the applicant's custom to issue statements to the agency and a recent one is not available. Under such circumstances, unless information removing doubt concerning the risk is obtained thru other sources, it is sound credit practice not to grant unsecured credit.

4. *Handling new orders.*—On the arrival of a new order, the mercantile agency's rating book is first consulted in order that the rating given may be noted and the spelling of the name, the address, etc., verified.

The next step is to make out a triplicate "Notice of New Customer." These notices are padded successively in white, pink and yellow, or in any other three colors selected. They are worded exactly alike.

NOTICE OF NEW CUSTOMER

Business .....

Name .....

Town .....State .....

R. F. D.* .....Ship'g point .....

Rating: Dun..... Brad.....

Remarks .....

.....

.....

Limit $.....(Sign) .....

.....19 Credit Manager .....

*Rural free delivery route.

One sheet goes to the sales department, and shows at once that the order is from a new customer. If sufficient credit data are at hand the credit limit may already have been fixed, and will in that case appear on the sheet in the place provided for it. Where the credit limit is missing, it shows that an investigation of the risk is still being made. The information contained on this sheet is used by the sales department as a means of classifying the customer, and affords at the same time a basis for a letter acknowledging the order, or for whatever other correspondence may be called for.

The second sheet goes to the bookkeeping department. Its receipt is a warrant for the bookkeeper to open an account with the dealer named thereon. No new account is opened without authority from the credit department.

The third sheet remains in the credit department until the investigation is complete. Whatever additional information may be obtained is attached to this sheet, and the final limit is indicated. Thereupon the credit man's signature is affixed, after which the papers go to the bookkeeping department, where these later data are duly noted.

5. *Discrimination in credit-granting.*—If the credit-seeker is one who possesses means, even tho he lack present command of them, he is ordinarily entitled to credit at the hands of the merchant. No country merchant hesitates to extend credit to his farmer-neighbor whose growing crops, tho still un-

harvested, give abundant assurance of their owner's ability to pay his bills in due time. In the same class may be put the salaried person whose regular income is sufficient for his wants and who lives well within his means. Especially is this true if he is the head of a family and, as such, permanently located in the community. An unmarried man is regarded by the retailer with less favor as a credit risk. The same is true also of a married woman not legally responsible for her obligations.

The intemperate, the gambler, the manifestly incompetent, the shiftless and the idler are necessarily unworthy of credit favors and should be made to pay cash for their purchases. Persons suffering from an apparently incurable disease are also regarded ineligible as credit customers unless, of course, they possess sufficient means to assure the payment of their account even in case of their death.

A good rule that may be followed with perfect propriety in extending credit to "charge customers" is to put the burden of proof upon the credit-seeker. It is perfectly reasonable to assume that a person who desires to obtain a merchant's goods in exchange for a promise of future payment should be willing to state on what grounds he bases his expectation of being able to make the payment at the designated time. This is the principle upon which commercial credit is today asked and given. It should obtain equally where personal credit is sought.

6. *Understanding as to terms.*—In both retail and

wholesale credits, the amount of credit to be given and the date upon which payment is to be made are likewise subject to prearrangement. Once determined, these matters should be regarded with due seriousness. If they are not so regarded, it is generally the merchant's fault, in that he failed to impress upon the customer in the beginning the fact that he was expected to carry out to the letter his part of the agreement.

If the exact time of payment has been agreed upon in advance, it devolves upon the debtor, in case he becomes delinquent, to show cause why the amount is not paid according to agreement. Many merchants take the position of regarding the customer's payment of his debts as a favor, leaving with him the impression that such payment may be withheld if it is not entirely convenient to make it at the time it is due. This mistaken attitude is responsible for many bad debts and unpaid bills. A debt is always an obligation and must be so regarded by both parties to the transaction. If an extension of time is desired, it is the debtor's duty to obtain the creditor's permission for such extension. Payment cannot rightly be deferred without the creditor's consent. The principle applies to retail credits just as fully as it does to credits in a wholesale house.

7. *Holding the order pending investigation.*—In case an order must be held for lack of sufficient credit information, the carbon duplicate, before going to the sales department, is usually rubber-stamped "New—

Held for Credit." At the same time a notice is sent to the salesman informing him that an investigation of the customer is pending. This is done so that the salesman may be kept in touch with the progress of the order. When the information is complete and the credit limit is fixed, the salesman is again notified, in order that he may have opportunity to comment on the credit man's decision if he considers such decision unjust to his customer.

8. *Final disposition of the order.*—The investigation now being completed and all data desired by the bookkeeping department being duly entered upon the ledger account, the credit information is filed according to whatever filing system is used. For the sake of convenience, and as a check upon the correctness of the address, etc., an index card is made out. With these cards at hand, the credit man is always in immediate possession of the salient points touching his customers. All further information relating to the present status of their accounts is, of course, readily obtained from the bookkeeping department.

When the card ledger system is used, an additional column may be provided to show the present balance, thus indicating at a glance the condition of the account. Places are also provided for the ratings and for the credit terms as well as for the data abstracted from the various credit sources that may have been used, covering the customer's character, capacity and capital. From time to time, this brief is revised or enlarged as new information comes to hand.

9. *Departmental organization problems.*—There are a number of points that may profitably be kept in mind as affecting the smooth operation of the office system. One has to do with the location of the department as closely as possible to the correspondence files, the accounting department, the complaint bureau or the sales department.

If the use of the ledgers by credit or collection department employes is likely to interfere too much with the bookkeepers or if these ledgers are too far away for easy reference it may be necessary to duplicate these records at a good deal of expense.

Since the back-bone of the credit department is its files, it becomes the problem of the man in charge not only to provide proper filing equipment to meet the needs, but to make sure that they are properly coordinated so that employes of the department can get along without referring to several files each time the records are consulted.

It has been suggested by one authority that any system would require at least four different files or access to them: (1) the customer's account ledgers, (2) agency report files, (3) invoice file, (4) correspondence file, which provide the necessaries of any credit and collection system; a record of the account, the follow-up and the assignment of routine work among members of the department.

The credit man, in addition to his responsibility for reducing a large part of the work of his department to a routine which will handle a vast amount of detail

without the need of his devoting personally any great amount of time to it, must make sure that the routine he adopts is as inexpensive as possible to maintain.

It will probably not be necessary or profitable to attempt to describe the physical equipment of the credit office or of the files. This is particularly true because the forms used for ledgers, card files, correspondence files and the like must in nearly all cases fit the individual requirements of the business.

10. *Standardizing the departmental routine.*—As fast as the procedure to be followed in the department for handling routine details has been worked out, it should be outlined definitely in the form of a departmental manual. In it should appear, in form of an organization chart or otherwise, the duties and responsibilities of every person in the department with the relationship of each to the department as a whole. This manual will of course be subject to constant change and revision and so may conveniently be kept on loose leaf sheets suitable for a ring binder.

The routine operations that occupy the larger part of credit department work are probably the examination of the customer's ledger accounts and passing on customer's orders.

Analysis will show the number of accounts a clerk or a bookkeeper can examine within the periods between mailing schedule dates, so that there will be no slippage, waste of time or lack of attention to the follow-up.

11. *Departmental reports.*—As an actual gauge

of the effectiveness with which the department is being administered, nothing can replace the report submitted weekly or monthly in comparative form.

Some of the items that should be shown are:

1. Volume of orders passed.
2. Volume of orders rejected.
3. Volume of orders held pending investigation.
4. Percentage of losses to sales.
5. Volume of collections.
6. Cost per dollar of collecting.

Items which bear upon departmental activities in relation to the reserves for bad debts, expense of operating the department as provided in the budget, and others of the same kind are naturally to be included.

REVIEW

Describe the successive steps in credit and collection procedure.

What are the advantages of standardization in credit management?

Describe reports which can usefully be made of credit department operations.

CHAPTER XII

COLLECTING THE MONEY DUE

1. *Determining the collection policy.*—Sermons on efficiency preached at and to business men of late years have hinged generally on one of two texts, "Increase your turnover of stock" or "Collect the money due you." From the first the injunction is drawn, "Keep your capital at work, not tied up in goods on the shelf," while the second leads to the advice, "Keep your capital at work for yourself, not for somebody else to whom you loan it." What this involves is now to be considered.

The modern business concern takes a broad view of its collection function and does not confine it to the narrow limit of running down "dead beats" and grinding out statements of accounts to regular payers. The manufacturer, jobber and retailer of today gives careful study to his collection policy, to make sure that it fits logically into his marketing plan. Indeed, the seller's entire organization from president down to shipping clerk has a part to play in the distribution of his goods and in securing payment for them—the real completion of the sale. It is necessary nowadays to adopt policies for the collection department as clearly defined as those of any

other department in the business. All must harmonize with the general policy of the house.

The modern collection department has its part to carry out in the details of the marketing plan. At the same time it simplifies its own problem and enhances its dignity, when it endeavors to resell the concern's product and its service to the slow or delinquent or dissatisfied customer; when it seeks to stimulate in him the will to pay and the ambition to keep in good standing with the house.

In part these purposes can be accomplished thru helpful advice to customers who get themselves into difficulties. Time extensions are not the only aid that can be rendered. It is proving to be good business to stand ready to help constructively in the solving of marketing, financing or collection problems of the customers. Men, it is true, do not always keep their promises, but they keep them better when they are aided in so doing. Instances are multiplying of business concerns which have been helped to get back on their feet after periods of financial stress and which have later developed into extremely valuable accounts. In part it was due to consideration shown, but in still larger part, to the wish to help rather than to the effort to force payment, by the collection department. Such customers become the true friends of the house—and the collections problems, as far as their accounts are concerned, disappear.

2. *Putting the policy to work.*—The successful application of a broad constructive policy in collections

requires the same skill and forethought as the working out of sales, advertising, buying or credit policies. Haphazard or irresolute plans consisting of a few "schemes" may be out of harmony with the nature of the business or the reputation of the house. They will be inadequate.

Bringing in the money without making enemies or losing trade—the aim of every collection plan—depends for its success largely upon the tactful persistence with which the policy of the house, once determined, is carried out. A system which works with clock-work precision, massing the details of operating any collection office into groups for the purpose of standardizing operations, will produce collection department results at minimum expense.

3. *Need for a general house policy on collections.*—Obviously, if the collection function is to be exercised in anything like systematic fashion, if it is to be closely related to the business as a whole and is to have a direct effect upon the latter, it must follow a definite policy. This policy should be elastic enough to cover, by general rules, all the points which are constantly arising thru the contact with customers regarding collections.

Among the questions commonly raised in this way may well be those concerning terms offered. How strictly are they to be enforced? Will it be wise to charge interest on past due accounts? What shall be the policy when extensions are asked? Is it desirable to refer stubborn accounts to attorneys to collect?

Shall we exchange credit experience with others? Shall we accept cancelations and goods returned without cause?

4. *Making collections "constructive."*—It must be remembered that collecting money due the house is an important part of the marketing plan. Many business men make the mistake of approaching collection problems with something like distaste, with the feeling that they are conditions arising from some business malady, a necessary evil. Since no sale is complete until the money due is collected, this function of the business ranks with selling and advertising in the program of distributing a company's product.

The work of collecting is strongly affected by the work of the other departments of a business. If sales are forced and improper representations are made, collection is difficult. If new selling plans in new fields are launched, the collection plan must meet all contingencies. If the claim department bungles its adjustments, collections are held up and effort is wasted. If the manufacturing department has failed to maintain quality, collections may be slow or impossible.

5. *Building good-will thru collection methods.*—Successful collection effort must induce on the part of the customer the will to pay for what he has bought. If the customer can be impressed again with the same desire to possess the goods that originally impelled him to buy them, in spite of the interval between their purchase and their use or their sale to others, there will

be no collection problem to solve. While the interval allowed in the form of credit extended may have dulled the buyer's original desire for the goods, or his conception of the profit to be made by selling them again may have weakened, it is possible by following correct collection practice to reawaken it and thus establish a resale.

Efforts to reinduce the buyer's original wish to possess the goods he has purchased, by appeals to his self-interest or his desire of gain, are at times fruitless, and the collector's effort must then play on the customer's habit of meeting his obligations, his natural dislike of wrong-doing and his fear of the law. In such cases, then, the collector is not selling the goods but rather the sense of obligation, the desire to do the right thing and freedom from worry or threat of legal action.

The process of reselling builds good-will; it fixes a continuity of interest with the customer and develops his account as an increasingly valuable outlet for merchandise. In applying the principle of resale the collector has open to him a variety of suggestions and appeals heretofore employed only in sales and advertising. The benefits of an effective collection effort are many. Among them are the reduction of accounts receivable, the rendering available of more capital to carry on the business, increased profits thru decreased expenses, a shortened credit period, conversion of delinquents to discounters and the establishment of a line of customers who are financially sound.

6. *What is to be learned from complaints.*—In a certain Pennsylvania store there was a clerk who kept what he called an "error book." In it he entered the "reasons why" when he lost a sale. In spare moments he went over the reasons he had jotted down and did what he could to prevent future losses thru the same causes. Here are a few entries:

> Customer had to wait too long for change.
> Did not have size collar in stock.
> Goods asked for in stock room, customer would not wait.

The idea, developed further, proved valuable as a sales saver for the store and, because it put special emphasis on the importance of store service, it reacted to reduce complaints to a minimum.

There never was a business so well conducted in its relations with its customers that did not receive, at least occasionally, complaints which called for adjustment. In every business organization, then, some provision must be made, in the form of a "complaint department" or "bureau of adjustment," for looking after such matters. When a concern reaches the point where it realizes that every complaint received is evidence of a live customer at the other end, it begins to see itself as others see it, and it may find in its complaint bureau the most valuable gauge which could possibly be obtained of its value in the community.

Since every complaint, no matter how small or how unreasonable, has in it the germ of an excuse for the customer's delaying or refusing the payment of money due, to say nothing of his switching his trade elsewhere if he feels that his grievances are not properly righted, the collection man should be among the first to know all the facts.

In many instances it has been found best to put the responsibility of answering complaints and making adjustments in the hands of the same man who handles collections. There is much to recommend such an arrangement in the effort to prevent losses and to make closer collections. It emphasizes, too, the money value of handling complaints in such a way as to make friends instead of enemies.

7. *Classification of debtors.*—In the collection department, customers are naturally classified according to the promptness with which they meet their obligations.

The basis for any successful effort to collect money from a concern's customers is found in some accurate and as nearly as possible automatic means for separating those who pay promptly from those who are not quite so prompt; and those who show unmistakable evidence of being bad pay from those who are execution proof after having resisted all effort to collect. Obviously, if the procedure is to produce results, it must be different for each class. The big advantage for the collection manager of classifying debtors, lies in the close and accurate knowledge of his

accounts that is thus made possible. Because they are broken up in groups with similar tendencies, he is able to study them to better advantage and apply the treatment which is most needed.

With such a classification completed and rigorously maintained, he is enabled to handle a much larger number of accounts than would otherwise be possible. While there will always be debtors who will require special treatment, the larger number of delinquent accounts, in the groups thus classified, can be handled by means of a fixed routine, and the work which is guided by a definite policy can be entrusted in a large measure to the assistants in the department.

8. *Good pay.*—Obviously, any customer is considered good pay who does not let his account lag into the "past due" class. He pays voluntarily on or before the due date or with reasonable promptness after his account becomes due. Such customers require the minimum of attention and expense and it is naturally, perhaps too hopefully, assumed that all new accounts accepted for credit will belong to this class. They are so rated until there is evidence of a contrary nature.

The delinquent classes are recruited from among those who once were "good" and hence there is a definite responsibility on the collection manager to go over his good account files constantly to see that any slipping backward tendency is promptly checked. Many times a good paying customer is allowed to neglect his account until it reaches a point where the

amount is beyond the debtor's power to pay promptly. When this occurs, the customer enters the "slow pay" class which comprises those who "fully intend" to pay their debts but who for one reason or another are not able to do so promptly because of poor management or seasonal conditions or some other circumstance beyond control. Sometimes the collection manager is himself responsible for recruiting the slow pay class from among the "good pays" because he misjudged the customer on the credit department's facts or failed to follow him properly, with the result that the money which should have gone to pay his concern's account has been expended elsewhere.

9. *Slow pay or on "probation."*—Slow pay customers are frequent in rural trade where buyers depend upon the crops for their income and pay their debts when the harvest is ripe. Such debtors might perhaps be better classified as "deferred" because while they are perfectly good, they pay in their own time.

Another subdivision of the slow pay class is made up of those who are honest, whose intentions are the very best, but who thru miscalculation or unexpected demand or misfortune are unable to meet their payments as they fall due. Such debtors require very careful treatment. Unless the collection system provides for properly nursing such accounts back to normal by careful study of the facts and some arrangement for small payments, the losses are likely to mount up, not alone in money but also in good-will and potential business from customers who might

have been helped back into good financial condition by the right kind of cooperation.

It is no uncommon thing to find among these slow pays, debtors who, while being perfectly good, make it a part of their business policy never to pay until they are forced to do so. They reason that the longer they can keep the money in their possession the longer they will have the use and benefit of it. While they do not ordinarily go so far as actually to stand suit, they often go to a point just short of that.

10. *Delinquent or bad pays.*—The next class of debtors in degree of difficulty of collection comprises the "bad pays"—the really hard up and unfortunate, the gamblers or "shoe string merchants" who are good for the amount and who pay at the last moment but who have no regard for their credit standing and who should never have been trusted; as well as the professional dead beat.

The dead beat has been described as a post graduate of the school of extravagance. The percentage of dead beats is much higher among married men than among bachelors. People of the dead beat class never pay any attention to demands from the collection department. They are rarely accessible to the collector and if they are discovered by accident they are profuse with many promises which are as easily broken as made. The only hope with debtors of this class is to follow them so relentlessly that payment finally appears to them the lesser of two evils.

11. *Execution proof.*—Under the classification

"execution proof" may be placed the residuum from all other classes—the accounts which have defied all efforts to collect and which, because the debtors own no property, cannot be forced to pay thru resort to legal action. These are the accounts that are written off at the end of the year. To some extent they represent the failures of the credit and collection departments since it is here that the mistakes of both are buried.

Taking risks on the integrity, the trading ability and the financial sense of the dealer customer is an essential part of the manufacturer's or jobber's selling. Holding the risks down without hampering the sales force is the job of the credit man with the help of the collection department. In order that the business may profit by mistakes in the past and prevent them in future dealings and that it may correct possible wrong tendencies in credit and collection policies, it is suggested to every credit and collection department that a periodical inventory of collection losses—analysis and close study of this residue of charged off accounts—may be well worth while.

If each case is studied with the salesman at regular intervals to determine what caused the trouble as well as how it might have been detected in time to save the dealer and keep the house from loss, much can be learned about holding the proper balance between safety and maximum volume of sales.

Such an analysis may show that the loss was inevitable because the customer lacked fundamental

knowledge of store management—location, financing, right buying, relation of mark-ups to cost of doing business, and the like. It may show the error to be that of the credit man for not detecting this weakness or that of the collection man for failing to note it and for not coming to the rescue with help and cooperation to off-set the handicap and thus save the account.

12. *Planning the system to carry out the policy.*—If results in any appreciable volume are expected from the collection effort, they cannot depend wholly upon the personal skill of the collection manager. More important is the extent and thoroness with which he is able to develop a routine system for handling the details of his work. The essential benefit of such a system is the planning and arrangement of the work in such orderly fashion that the accounts will be promptly and automatically brought up for attention and a record of each collection step recorded until the final payment is received.

There are a number of lesser points of routine policy which must be decided upon, as, for example: Shall we use sight drafts? If so, how soon in the follow-up? Shall we use form letters, a printed statement and reminders only? How long should we allow between follow-ups? What use shall we make of advertising or inspirational inclosures with bills? Shall we suggest trade acceptances? If so, what sort of educational campaign do we need to introduce them to new customers? The list is not intended to be exhaustive, merely suggestive.

When the general policy and organization of the collection department have been established and the system under which it operates has been properly worked out, the man in charge can delegate a large part of the detail operation, such as filing cards, posting reports, handling routine correspondence and initiating the follow-up, to trained assistants. It should be particularly noted, however, that these very details are much more important than they may seem and that the assistants in whose charge they are placed must be constantly watchful and accurate.

Few collection systems can be installed and successfully operated in all their details without change or adaptation. Usually they are the result of gradual development—characterized by changes and improvements introduced here and there as new and unexpected needs arise.

Where no carefully planned system for handling collections, geared to the general policy and growth of the concern, is in use, there is a resort to haphazard methods with the usual outcome, haphazard results. There will be delays in noting delinquencies, costly mistakes in handling customers' accounts and general demoralization and loss resulting from uncollected debts.

It is impossible to outline any one collection system that may be fitted exactly to the needs of all business. While all are devised with the same end in view, they must differ in details according to the nature of the

business served. The chief requisites common to all, however, are simplicity, accuracy and economy of operation.

13. *Effect of trade usage on collection policy.*— Habit, the instinct that decides a man to act successively in the same way in response to the same impulse, is perhaps the most valuable ally of the collection man. Habits or precedents granting certain terms and conditions of payments are developed in certain lines of industry no less definitely than habits are formed in individuals. Thus trade custom or usage arises. Sometimes it may be extremely desirable for collection purposes to change these customs, but it presents a very difficult problem to do so.

Some explanation of the variation in credit terms in different lines of business has already been given. We have seen that credits run for periods that are of varying length. Often it is for a duration of thirty, sixty or ninety days. Sometimes the credit may be granted for a length of time extending over months, as in seasonal lines, thru the system of post-dating.

These periods are imbedded in trade usage and are well-nigh unalterable. Because of this the collection policy must obviously be carefully planned to take such special conditions into account. Clearly the consumer or the retailer will favor the manufacturer or jobber who gives him the most favorable terms. Also he is inclined to resent any attempt to change established habits of paying unless he can be shown some advantage to compensate him for doing so.

REVIEW

What should be the relation of collection policies to general house policies?

How may complaints be made fruitful in developing business methods?

How does the collection man classify debtors? Describe the several classes.

What effect does trade usage have on collection policy?

CHAPTER XIII

THE COLLECTION MANAGER AND HIS WORK

1. *Personal characteristics.*—It has been suggested that "a credit man should be of an investigative turn of mind, and should have an agreeable yet indomitable obstinacy." This is also a happy combination of qualities for his Siamese twin, the collection man. An investigative turn of mind indicates caution, deliberation, vigilance and sagacity, while agreeableness, courtesy and respect are affirmative business-building characteristics. These virtues, when tempered with obstinacy, produce the positive qualities of a good collection man.

Since the responsibility for collecting accounts due the house is closely related to that for accepting the account in the first place as a reasonable risk, it is often found merged in a single head credit man. If the collection manager is not a credit office assistant, but an independent official, he should work in the closest harmony with the credit office. He should be able to command its facilities for gathering information and to utilize its records, in order to bring about the prompt payment of money due.

Losses occur only in small proportion before accounts mature. It is after the accounts reach the collection manager as a rule that the weakness of the

creditor becomes apparent. The responsibility rests upon the collection man to reduce actual losses to a minimum. Generally speaking, his results are accomplished thru his patience, insistence and persistence.

All men are not equally qualified for collection work. Some personal characteristics among these qualifications assist their possessors materially. Some are acquired thru experience; others are the gift of nature. Among the latter, perhaps the most valuable is an even disposition, one that is not likely to betray its owner to sudden loss of temper or despair of collecting a difficult account. Sympathy and imagination are almost prime essentials. If the collection manager shows interest in the debtor's troubles, if he wins his confidence and thus induces him to talk, the chances are that, based on the information obtained, an arrangement of some kind can be made for payment of the debt. Sympathy cannot of course be allowed to degenerate into weakness. When information cannot be gained directly from the debtor himself, the collector with an imagination can place himself in the debtor's position, and by utilizing his own experience and his knowledge of the many methods by which payments are made, may be able to suggest a plan by which the debtor can meet his obligation.

Of the qualifications that may be acquired, the first importance must be given to the ability to judge human nature. If this power were perfectly developed, the science of collections and credits also

would be an easy one to master. The knowledge of human nature—knowing beforehand what people are likely to do under given circumstances—comes with experience and from contact with others. In handling collections, however, too much reliance cannot be placed on one's unsupported judgment of human nature, nor must appearances be given too much weight, for they are often deceptive. Facts and figures, certified, where necessary, by a public accountant, form a better basis for credence than good clothes and a plausible manner.

Courtesy, a most essential qualification for successful collection work, is, we believe, one which any one can acquire. While it is obvious that the collection man must not feel himself bound to accept any excuse, and while he must not fail to press his claims properly, nor weaken in his demands for what is due, courtesy must, however, control his manner and expression no matter what his action may be. Sometimes a harsh, threatening and overbearing manner is necessary, but such tactics are always dangerous unless the collector is sure of his ground. They arouse antagonism on the part of the delinquent, repelling him when otherwise he might have made a settlement. On the other hand, more people, debtors included, are likely to respond in kind to good treatment accorded them, and many a debtor has been shamed into paying a debt long due solely because of the courtesy and decent treatment shown him.

A good collector is therefore courteous but firm.

He collects closely and in doing so makes it impossible for lagging debtors to lapse back into delinquency again. If the collection policy adopted by a concern drives customers away for no other reason than because they take offense, then those in charge are open to the suspicion of unfitness because they fail to sense the need of courtesy.

Patience and persistence are two more qualifications important in the make-up of the successful collection man. The delinquent must be persistently followed and patiently attended if his habits of carelessness and neglect are to be overcome. Many an account has been hopelessly lost as a result of quick, hot-headed action. In the same way many accounts actually given up for lost and charged off to profit and loss, have been turned into money thru an exercise of patient persistency by the collector. Patience is often rewarded because the financial condition of individuals changes as time goes on. The account that is uncollectable today may be perfectly good six months or a year from now. When the time comes, if the debtor knows that the collector is still after him he will often settle voluntarily.

2. *Relations of collection to credit department.*—Collection work is sometimes done directly by the credit department, sometimes by an independent department. However organized in any particular case, there are of necessity very close relations between credit work and collection work which should be clearly understood.

If credit granting were an exact science and a credit man could be found who was infallible there would be little need of a collection department, either under his own charge or in charge of another. No matter how carefully credits are checked, mistakes will be made, misrepresentations made will secure credit that should never have been granted, or conditions will change after credit has been granted. In any such case careful collection effort is necessary to salvage the account.

The preparation for collecting should be made at the time the account is opened. Information can readily be obtained at that time, and as it may be needed later in collecting the account, nothing which may be pertinent should be neglected. Definite knowledge of the customer's financial status will not only enable the credit man to decide upon the credit to be given and the limits to be set, but will also help the collection man to judge from the facts the causes of delinquency and to decide upon the best method for handling the collection. In addition to the information gathered at the time the account is opened, it is most important for collection purposes to provide facilities for keeping thoroly posted on all events and developments possibly affecting accounts. Business failures, deaths, marriages when the accounts of unmarried women are affected, fires, floods, strikes, changes of fashion, financial disturbances—all these and many other events may affect a customer's paying power and should be promptly noted.

With such events in mind, it is not sufficient that the collection man simply lock the barn after the horse is stolen. As a part of the constructive service which he is able to render, he should be enough of a student and an analyst to look ahead and to anticipate the probable reaction from strikes, floods or wars, so that he may be ready armed for any emergencies. Thus, by adopting counter measures, he helps to neutralize the effects of disorders and disasters and minimizes the losses which flow from them. Assuming that the credit department's preliminary investigation has been thoro enough to establish a customer's right to credit according to the standards of character, capital and capacity, the collection man's job is to keep his ears close enough to the ground to detect the faintest indication of lapses from satisfactory standards and to act accordingly.

3. *Using credit office machinery to assure collection.*—If it is essential that the credit man make use of all possible sources of information at the time when he is judging an applicant for credit, the collection man needs an equally free hand to use all these sources when it comes his turn to handle the account. Credit department files reveal to him the statements furnished by the applicant at the time of opening the account and at intervals afterwards. Reports of salesmen calling on the trade, sent more or less regularly to the credit files, should be open to him for reference at all times. The privilege of calling for special reports on doubtful customers thru the

commercial agencies or banks or thru local bureaus and the interchange of information and experience offer quick sources of information just as vital in importance for the collection of accounts as for opening them.

One of the most useful sources of information on customers, for later use in the collection of accounts, should be the salesmen. The man on the road can report significant local items, such as strikes, depressions, competitive conditions and shifting of market centers, as well as the characteristics of customers. One credit man had the right idea when he explained to the salesmen that the most helpful things they could tell him about a retailer were the things which enabled him to picture the customer when writing a letter to him. Is he a big, heavy man with sandy hair and a hearty laugh, or is he small, thin and dark eyed? Some business houses even make it a regular practice to collect photographs of their customers and their places of business because they find these aids very helpful in handling their accounts from a distance.

4. *Organization of collection department.*—The answers to the question, "What is a hundred per cent efficient collection manager?" vary with the speaker. The board of directors would consider him "one who collects one hundred per cent of the indebtedness shown on the books." The sales manager would say he is "one who collects without killing future business." The rank and file salesman would define him

as "one who forgets overdue accounts." The real definition, however, as collections are viewed in modern business concerns, would be "one who collects, yet creates good-will and paves the way to greater yearly sales by making a purchaser into a better customer."

Probably in seven cases out of ten the collection man who is responsible for sending out statements and writing letters to slow or delinquent accounts is the credit manager's assistant; collections are then considered as part of the credit department's work. In such cases the responsibility for both credit and collection initiative and policy is centered in a single head. In other concerns the two functions are entirely divorced and organized as two separate and distinct units with a head for each department responsible for the performance of his own particular function.

The advantage to be gained from such a division of function is more apparent in a large organization like the city department store, where there are thousands of accounts constantly being opened and where in the same way there are always thousands of accounts to be followed for payment—enough work to keep one man busy. Another advantage of a separate collection department is to be found in the constant and independent check provided on the work of the credit man, whose judgment in opening accounts for credit is constantly being put to the test when they come to the actual payment of accounts.

5. *Responsibility.*—Whether the collection man is

classed as a sub-department head who reports to the credit man as the really responsible head, or whether he is accorded the dignity of an independent department, the responsibility upon him to produce definite, dollars-and-cents results cannot be dodged. Furthermore, the results which he must produce bear a very definite relation to the amount of money tied up in accounts past due and to the definite amount appropriated on the basis of past experience as the limit of cost per dollar collected beyond which the concern cannot afford to go.

Restricted on one hand, therefore, by the credit policy of the house which passes upon the risks which may be accepted, and on the other hand by the collection costs, it is no light task for the collection man constantly confronted by emergencies resulting from fires or floods or crop failures producing conditions that no one can foresee, to show consistent returns in money collected. Yet that is exactly his job.

6. *Training for the work—special and general.*— While it is possible to state the qualities which are desirable in the "ideal collection man" in a general way, the training which will develop these qualities is a matter on which a good deal of thought has been expended without reaching conclusions or generally accepted standards.

In addition to his technical knowledge of collection psychology—the character, instinct, likes and dislikes, desires, ambitions, habits of thought and action peculiar to people who buy on credit and the knowledge

of how to induce action, the collection man needs a working knowledge of law and of his company's market, its product and policy.

One concern took the preliminary steps in the training of its collection man when it asked him to deliver a package to a small city hardware dealer and to find out why the latter's overdue account had not been paid. Having delivered the package and having secured a promise to pay, he found that the dealer simply didn't know what to do, first to get and then to hold trade. By means of suggestions drawn from a knowledge of good merchandising methods, the collection man helped to change that hardware dealer from a prospect for the sheriff to a merchant who discounted every bill.

By the time this man had learned that nine times out of ten when a retailer failed to pay promptly the latter may have thought he was getting square for some grievance against the creditor's house, he knew the retailer's real problem was to be found in his own business methods. Where the manufacturer or jobber finds his retail customers falling behind in their payments on account, the creditor's first step should be to find out in what ways the retailer is a poor business man.

After two years' further experience, one as a traveling collector for a hardware jobber and the other as a salesman for the house, this candidate for the job of collection manager came to know every excuse for deferred payments so far invented; the sick wife, the

lost check book, the failed savings bank, the dishonest partner, the delayed payments on sales to the city and the thousand other inventions of the delinquent retailer.

The number of men who offered such excuses, however, he found small as compared with the ones who said, "What am I going to do? This business is going down hill. I'd pay you, but if I did, I'd starve. You'll get your money as soon as I get a little ahead of the game."

In this situation the skillful collection man finds that he needs a knowledge of store finance and the lines and quantities a store should carry, since to get a delinquent retailer to pay promptly it may be necessary to show him how to figure costs and make profits.

REVIEW

What are the qualities of a good collection man?

Why should the collection man be closely associated with the credit department?

What are the arguments for and against his being a subordinate of the credit man?

What are the responsibilities which a credit man undertakes?

How may men be trained for collection work?

CHAPTER XIV

PRINCIPLES UNDERLYING COLLECTION EFFORT

1. *The debtor's motives.*—When passing on applications for credit, it is recognized that all obtainable information about the customer should be made a matter of record. It is important that the collection man study this information on the customers of the house, that he acquaint himself with their habits of living, of buying, of paying, of thinking. Consciously or unconsciously, he comes to be a student of other people's motives, an expert in the reasons why men do or think certain things under given circumstances. The more exactly the collection man can reduce to definite principles the motives which actuate people who owe money, the more successful will be his efforts to induce the settlement of their accounts. From many possible steps, the collection man must take the one which will be most effective under given circumstances. Experience has shown him the power of habit, the importance of securing and holding attention, the value of appeals to instincts and ambitions to which nearly all men respond automatically, and the value of suggestions which bring the desired reaction.

From earliest times, human motives for thought

and action have been substantially the same. Among the more common ones are reactions from hunger, cold, self-defense, pride, love, enjoyment and alleviation of suffering. Certain ideas or impressions relating to each of these are firmly planted in our minds thru long custom and use. The merest reference to them will awaken associations and memories that stir us powerfully. The mind is stored with memories of acts we have performed because of our interests in our health, our homes, our families, our success or our desire to make or to save money.

As a consequence, even the suggestion of these interests moves us powerfully toward action. Open discussion, which may arouse opposition, is sometimes less effective than indirect suggestion, because action often follows without the realization that we have responded to any stimulus outside of our own minds. In such instances we feel that we have acted chiefly on our own initiative, and would perhaps be astonished if told that we had been skillfully persuaded to act.

Hence the collection man, having studied the general mental operations of the man who is asked to pay a bill and having discovered the usual trend of his thoughts, will work with it rather than against it. Next he studies his customers to see whether there are any special motives to which they are likely to respond and which he may use in the process of securing payment. He examines the relations between the house and the customer to ascertain if possible

what fixed impressions have been established in the customer's mind after months or years of business dealings. These will relate to such things as values in goods, prices, service, accommodation and credit.

If an honest review of the customer's relations shows that the true values of these things are not well established in the latter's mind, the collection man determines that he will implant them there by selling to the debtor in good earnest, pride, savings acquisitiveness, competition, initiative or patriotism. Having done that thoroly, there is no need to sell or induce negative states of mind like fear, shame, or the desire to avoid annoyance.

2. *The right mental attitude.*—Before an appeal can be made successfully to any one of the varied motives that may be involved in the payment of a debt it is necessary to know what kind of debtors one has to deal with. Where there are many thousands of accounts to be handled this does not appear to be an easy thing to accomplish. Yet by the simple process of grouping debtors into classes according to the degree of promptness with which they make payment, he is able to judge approximately which appeal will be most desirable. Having completed the process of classifying debtors by the promptness or the slowness or the chronic delinquency of their payments, the process of applying persuasion or pressure to induce payment begins in each group according to its place in the collection scale.

For those customers who are always prompt to

take the discounts for their purchases, no more than a formal statement of account or a mild reminder of the obligation is required. But to those who by habit are inclined to take the full limit of terms offered, it may be advisable to add to the statement a letter which will convey just the right touch of friendly reminder of the account. To those who appear to be heading perilously near to the slow pay, careless or dead beat class, the appeals will probably be changed from pride, acquisitiveness, competition, or initiative, to fear or apprehension of consequences as most likely to bring results. The poor pay customer is not easily frightened, because he is callous by nature, or indifferent thru experience, so that ordinary collection appeals leave him unmoved. The collector who understands this type of mind and who can outgeneral it and surprise it will be able to score success where others fail.

Frankness without bluster, swift and determined advance from stage to stage of collection procedure with occasional appeals to self-interest and pride, together with a steady pressure for payment, will do much to convince the callous-minded delinquent that he has met his master and that further resistance will be too expensive to risk. It is no more difficult to use these appeals in correspondence than in interviews. The collection correspondent must write much as he would talk in such an interview, except that he will be much more brief.

3. *The personality back of the appeal.*—There is

added attention value and a more distinct impression on the mind of a sales prospect when a series of sales letters are varied in form and appearance. Collection results are likewise affected by variation in the type and appearance of the collection appeals. The unadorned invoice or statement of account, for example, because it emanates from the bookkeeper's desk, typifies the mathematical accuracy of the creditor's accounting record and gives an impression of regularity and routine. Such formal statements and letters typify the house in its general, impersonal relation to the customer and so produce a certain definite effect.

When, in the cases of customers who for any reason are in trouble and cannot pay, letters bear the signature of the collection manager, a different effect is produced because of the authority vested in his title. In the same way an appeal to self-interest or an offer of service or of leniency from the president of the concern or from some one obviously in a position to grant favors is likely to carry weight and influence which would not follow an ordinary letter.

Similarly an appeal to a delinquent's pride coming from an attorney or a collection agency or from some one obviously outside of the creditor's immediate organization will prove less effective than the same appeal from an officer of the concern to which the money is actually due.

Generally speaking, on this very account, except in desperate cases the advantage lies entirely with the

house which makes its own collections, because the usual outside collector, accustomed to deal chiefly with tough cases, is in most instances a poor diplomat.

4. *Value of repetition.*—The basis of a successful system of collections is the constant reminder of the debt—the repeated suggestion that payment is due and must be made. The constant repetition of the idea is in itself often sufficient to induce belief. The debtor who has been forgotten by his creditor, or who has for any reason failed to receive notice of his indebtedness, very naturally in his turn forgets the debt. On being suddenly requested to pay, his mental attitude is one of surprise. The first impulse is to deny the debt. Having denied it, the next natural step is to refuse payment. In such a case it is necessary to persist in suggesting to the debtor that he owes the money, since it is logical for that suggestion to become a conviction and a spur to payment. A forgotten obligation offers an easy basis for beginning operations. The object is to occasion in the debtor's mind a gradual remembrance of the debt, and ultimately an absolute conviction of his duty in the matter. In almost every case where the debtor denies the obligation, he does so from force of habit, but since he has denied it, the constant suggestion that he still owes the amount must be depended upon to bring to him sooner or later the conviction that the bill must be paid. Under the gradual yielding to suggestion the debtor who at first denied his debt will sooner or later be seeking a valid excuse for qualify-

ing his original denial. It is best then in presenting the forgotten bill, to go on the assumption that it will be denied. It is proper, therefore, to request the debtor to give a reason why the bill should not be paid. This allows him to make the natural response that he does not owe it. Then on being pressed again for reasons, after the collection man has answered his objections, he frequently begins to qualify his denial, thereby making ultimate recovery much easier.

Constant suggestion of even an obnoxious idea, will sooner or later occasion in the debtor's mind either some doubt as to the validity of his objection or the apprehension of trouble. That is why persistent dunning wears down objection after objection. The debtor cannot maintain an attitude of absolute indifference in the face of repeated suggestions. In the case of an honest obligation, he feels that he has either to pay or to fight. The more persistently the suggestion is made, the less marked will be his belligerent attitude, and the more likely his conviction that he is in the wrong. Accordingly in making the initial demand, a loophole should be left the debtor to qualify his denial, so that eventually he may back down and pay without any appearance of humiliation. The psychological moment will come when some newer creditor will cease to remind him of a more recent bill which he owes and should pay. If at such a time the insistence on payment of the old account is constant and forceful, the debtor will suddenly

pay to have done with it. Constant reminders will break down almost any denial or refusal.

5. *Need for salesmanship in collecting.*—Much of the success of collection effort depends upon the manner in which the constant reminding or dunning is done. The successful collector finds use for all the persuasion, logic and diplomacy that would be found necessary if he were selling goods instead of collecting for goods already sold. As a matter of fact, his work is that of selling and reselling to the forgetful and neglectful customer a sense both of his old obligation and of the advantage of keeping his reputation good in his creditors' eyes. Obviously, then, the letters which emanate from the collector's domain are really selling letters. They must keep the customer's interest in mind, and consider his business experience and his education.

Especially for the collection of petty accounts where the amount involved will not permit much outlay for collection expense, and in the cases of slow and careless but "good" accounts where it is necessary to cajole the customer into paying, bringing the matter to the attention of the customer is the most important step in the collection procedure. A letter that is personal in tone naturally receives more attention in such cases than the bald statement of the debt. There are many devices in common use for lending attention value even to formal statements of account. Explanations of terms printed in red, "stickers," or pasters to go on the invoice urging

prompt payment serve the purpose. Variety in the form of the collection appeal with an eye to the surprise value of "stunt" letters will sometimes bring results that would be impossible from an unbroken series of plain but colorless requests for payment. As with sales letters, however, there is an objection to the overuse of freak letters or collection devices in that they are apt to attract attention to themselves and not to the action desired.

6. *Utilizing the power of habit.*—Perhaps the most valuable aid to successful collection is habit. Actions at first induced by suggestion or initiative, eventually become habitual by repetition. A habit once formed is apt to be stronger than any first action likely to follow a certain stimulus. What a man has done once, he is likely to do again under the same provocation. A debtor who has once paid an account is more likely to pay again and again, than is a new debtor to begin making payments. For this reason the debtor who after a period of delinquency has begun to pay should be watched closely to keep him in the paying habit. It is necessary that the collector induce him to confirm this habit into one that cannot easily be broken.

In the case of accounts where payments are to be made in instalments, definite suggestions must be made as to the exact time and circumstances under which the next succeeding payments will be expected. He must not be permitted to neglect that date since to do so will break a mental thread in the debtor's mind. The habit should be fed and encouraged by

unfailing suggestion to impel payment of some amount on every date when an instalment is due. The debtor should never be allowed to put off a payment on the ground that he hasn't as much money as he had promised to send. The collector should insist on receiving some part of the amount at least, even if it is only a fraction of the sum expected. If the debtor is allowed to put off a single payment by a promise of a double payment next time, the payment habit is broken and the putting-off habit has been started.

It is just as important for the collector to acquire the habit of making regular demands for promised payments, as it is for the debtor to be induced to make them. If the former cannot habituate himself to regularity in a matter so important, he cannot in fairness expect to induce regularity in those whose delinquency occasions the need for his services.

7. *Appeals to the emotions.*—All collection appeals find expression either in *obligation* or *advantage.* Obligation is kept skillfully in the background during the earlier collection procedure but assumes a more and more prominent place in the follow-up. Pride, either personal, local or sectional; self-interest, thru the resale of credit or goods; savings, expressed in the desire for discounts allowed, or profits; good-will and cooperation, all these serve the collector's purpose.

The suggestion that payment should be made can be reenforced by appeals to the emotions, and those which may be drawn into play may be noted.

Appeals to good nature or to the customer's sense of fairness are commonly used midway in the collection procedure, just as it begins to assume a sterner cast and passes from the emphasis on the customer's advantage to that on his duty. In a class by themselves are the appeals to shame or to fear or the wish to avoid trouble.

One of the most treacherous emotions likely to confront the collector is anger. It will develop oftentimes as a result of no conscious suggestion by him. He will never arouse it intentionally unless he is perfect master of himself—of his own emotions—and unless he is able to recognize the psychological moment for action when the emotion of anger in the debtor has spent itself.

8. *Knowledge of the debtor essential.*—It should be plain that any attempt to describe the exact methods that may be used in applying the principles developed must be futile. These depend in a measure upon the knowledge which the collection man has of the particular debtor with whom he is dealing. Unless he has all the data available which give him an accurate mental picture of his delinquent's habits and characteristics, the work is likely to be perfunctory and ineffective. He should have at his command all the facilities of the credit office machinery, the cooperation of his concern's sales people, the analysis of the customer's past records. With such materials there is no real excuse for the failure of a capable collection man to get information.

The results from his efforts are never in doubt because they are shown in hard dollars and cents. There is no room for theorizing about them, they are the definite and immediate proof of his success or failure in collection work. There is much variation in business and great difference in people's habits and their reactions because of differences in localities, conditions and customs. Even tho principles developed from a vast amount of collection experience may be stated here, skill and judgment on the part of the collection man will always be required to insure their successful application.

REVIEW

Why is it important for the collection man to know as much about the debtor as possible?

Discuss the effects which are supposed to follow from formal and from informal demands for payments?

How does the collection man utilize the customary mental effects of suggestion, repetition and habit?

What is meant when it is said that salesmanship is essential in collection effort?

CHAPTER XV

COLLECTING ON A FRIENDLY BASIS

1. *Advantage and obligation.*—Two ideas, as has been noted, underlie the whole fabric of the collection system. First, it is to the customer's "advantage" to pay what he owes; and second, he has a definite "obligation" to pay. It follows then that the easiest approach to the delinquent is thru the friendly avenue of "advantage." It may be assumed that most men who buy on credit fully intend to pay. When they do not pay it is because when the time comes they haven't the money; because their plans have miscarried, or because other and more attractive uses for their money have arisen. Thus their conceptions of the advantages to be gained from carrying out their original agreements are dulled.

Obviously, it is the height of bad collection policy to emphasize too soon or too strongly the idea of obligation without first finding the real cause of non-payment and making sure that every possible effort to secure a settlement by milder and more friendly collection methods has been tried and proved fruitless.

2. *Need for getting at the causes of non-payment.*—Since it may be assumed that all men want to do what is right if the doing is not going to prove too

inconvenient or entail too much of a sacrifice, the collector begins his work by seemingly taking for granted that payment will be made when it is due. On this principle the preliminary steps in all collection systems take the form of reminders and formal statements which cannot possibly be construed as reflecting in any way unpleasantly on the customer's intentions.

When as time goes on some still fail to respond, it becomes necessary for the collection man to find out the causes for the delay. To get at the reason for non-payment is the chief purpose of the collection follow-up to those who have failed to respond to the first bill.

3. *Stages in collection procedure.*—In general, it may be said that collection procedure divides itself into natural steps thru the friendly stage where the debtor's account is presented to him from the viewpoint of his advantage. They are: (1) notification; (2) reminder; (3) reproach; (4) discussion, and (5) resale.

4. *Notification stage.*—In many concerns the invoice covering goods purchased is considered sufficient notification to the customer, and if it is not heeded the procedure is likely to develop swiftly to the draft and the unpleasant stage of collection.

The notification may take the form of a simple statement of account which is timed to reach the customer exactly on the due date. In other cases it is the practice to time the mailing of the statement long

enough ahead of this due date to reach the customer five or ten days before the account is payable so that he may get his remittance in to the house on the due date. In such cases it is customary to print on the statement some such notice as this: "Your account will not be due for ten days. This statement is sent for your convenience."

It is not uncommon practice to inclose with such notifications a printed folder or a blotter which carries a message of interest or inspiration and which by its appearance and general get-up will attract favorable attention to itself and thus bring the account unfailingly to notice. One wholesaler of food products in New York City varies the interest in such a series of folders by selecting for them subjects like "Hints for Effective Stock Arrangement," "How to Figure Turnover," "Savings Effected by Taking Discounts" and many other topics of the class designated "dealer helps."

5. *Reminder stage.*—It is fair to assume that when reasonable notification has been given and the payment is not received when it is due, the obligation may have been overlooked. It is not safe to suggest that the oversight was intentional, even in cases where it may be suspected that the delay was more deliberate. It is at this stage that a customer begins to classify himself as a prompt or a "slow pay" and it is particularly important that every tactful means be used to present the account squarely to his notice without giving any grounds for his taking offense. Conse-

quently, the mailing of bills or statements marked "Second reminder" or bearing stickers calling attention to terms, must be strictly impersonal and always courteous.

6. *Offer of concession.*—The offer of a cash discount is primarily intended to induce payment. The fact that a customer has failed to take advantage of it by the time his account reaches the reminder stage would seem to suggest the futility of opening any further concession. In some lines of business, however, where the discount is not prevalent, a concession for immediate payment is sometimes effective. In such cases the house pleads that a special emergency requiring cash makes it willing to settle the debtor's present indebtedness for a sum sufficiently below the full amount due as to make the proposition attractive. When this is done, as in the case of instalment houses, for example, it gives the collector a new argument offering a benefit to the debtor. The "money saved" argument, however, has no weight with the dead-beat debtor, who is trying to avoid payment of the whole amount; nor is such an offer suitable for most commercial houses because it sets a bad precedent.

7. *Discounting notes.*—A bank can often secure payment of a claim where an individual or firm cannot do so because the bank has a semi-public position which gives it greater weight and authority in the eyes of the debtor than is accorded to individuals or ordinary business concerns. If, therefore, a claim is in the form of a note, or can be placed in the form

of a note, and this note is discounted or deposited with the bank for collection, it is more likely to be paid than if carried in the form of an open account or presented by the creditor in the form of an invoice.

This is equally true of the trade acceptance or the acceptance draft. By reason of his endorsement of the instrument the customer has acknowledged his liability for the amount in question. It is frequently possible to secure a note or an acceptance in settlement of an account when, at least at the time, it is absolutely impossible to secure cash. If the note or the acceptance passes thru a bank for discount or collection the chances for payment are much better than if the indebtedness remained in the form of an open book account.

8. *Reproach stage.*—After the reminder stage, the next logical collection step deals with accounts which still fail to respond with payments or to offer any reasonable explanation of delinquency. This stage in the collection program may be called, for want of a better word, the "reproach" stage. Here brief typewritten or multigraphed letters begin to replace printed notices. The letters begin mildly to appeal to pride and the sense of obligation. Any formula that "resells" the value of the credit privilege extended or that tends to awaken anew the sense of duty to pay, comes into use at this stage. Not infrequently, this phase of the collection follow-up is ushered in with the use of bright colored stamps or labels pasted on the statement bearing such legends

as "Have you forgotten us?" or "Please," or "Statement of July purchases. Balance upon our books for purchases prior thereto. Please verify and report any error on this statement."

9. *Acceptance drafts.*—The ordinary sight draft as it is commonly used would not properly belong in this stage of the procedure unless it was very tactfully introduced or unless the traditions of a particular line of trade had made it customary.

The sight draft should be reserved for a later point in the collection procedure because it is not transmitted direct from creditor to debtor, but is sent thru the medium of a third party, the bank. To many a customer the bare idea of permitting a bank, whether his own or some other, to know of his indebtedness is extremely distasteful, and he should not be exposed to it until later when his neglect of the account more nearly justifies such action.

There is, however, an adaptation of the draft idea which is suitable for use in the stage of collection under consideration because it avoids the objections noted. It is the "acceptance draft," which is nothing more or less than the regular sight draft form sent direct by the creditor to the debtor, without passing thru the bank's hands, with the suggestion that the customer endorse his acceptance on its face and return it. Used in this way the device serves as a very effective notification of the obligation, and if accepted, supplies a bankable instrument which satisfies the claim.

10. *Sight drafts.*—While the sight draft is nothing more or less than a request for money that is due, its value in the collection process lies chiefly in the fact that it is not transmitted direct from the creditor concern to the debtor, but thru the agency of a bank. The bank which performs the service of presenting a sight draft may be one in which neither party has an account but simply acts as a collector. In the relations of the manufacturer or wholesaler with his dealer customers, where the drawing of a draft is an accepted practice at this stage, it is common to draw it thru the customer's own bank for the convenience and with the full consent of the drawee.

In cases where collections are to be made from difficult debtors it is better to arrange for the draft to be presented thru a bank other than that at which the debtor transacts his own business, because a strange bank is not so likely to favor the debtor by unduly holding the draft. Occasionally, a bank friendly to the debtor will hold a draft for weeks, or until the drawer has traced it to discover its disposition.

11. *Follow-up drafts.*—In cases where the creditor's draft is returned unpaid, a second draft may be sent out immediately and will occasionally produce results. There should be a letter from the creditor mentioning the first drawing, and taking it for granted that neglect of it was due to some misunderstanding on the debtor's part. This is desirable, first, because it gives opportunity for some straight collection talk, and second, because it prevents any misapprehension

on the debtor's part. The second demand and the letter will also impress the debtor with the creditor's intentions. The effect of his dignified persistency is increased by sending the second draft thru a different bank. Then the debtor feels himself hemmed in on all sides, and, being uncertain as to how far this process may be carried, foresees the effect on his credit—if he has any.

12. *Telephone calls.*—Somewhere between the reminder and the reproach stage there is an opportunity to make good collection use of the telephone for local or short distance claims. The telephone call is a comparatively mild measure, not to be trusted in really difficult cases, because the debtor may so easily cut off further argument or urging to pay by simply hanging up his receiver. For an ordinary slow account and for the purpose of getting a debtor definitely located, however, it is often as effective as a personal interview. When the creditor's message urging payment comes over the telephone from an officer of the concern, it may even be more effective than an interview with a mere collector for the house who at best is only a subordinate. There is one weakness in the use of telephone collection calls—the money cannot be secured then and there. The debtor's mind may be brought to the paying point and the collection man may, of course, suggest sending for the money at once, but if this is not feasible or not acceptable to the debtor, he must await the remittance.

For collection purposes, it is well to remember that

there are certain difficulties also in proving telephone conversations if the occasion should later arise requiring such evidence in a legal action. A person who attempts to prove a telephone conversation with another must, for example, be able to prove that he has previously talked face to face with that person and be able to swear that he would know the voice and recognize it when he heard it over the phone. The fact that most voices do not sound the same over the telephone as in ordinary conversation is a feature that must be considered in proving such telephone conversation.

13. *Registered letters.*—When a delinquent pays no attention to letters and is not accessible to personal calls or telephone communications, the registered letter may occasionally be used to good effect. In the letter one often calls attention to the fact that other letters have not been answered, or states the condition of the account, and any other details or circumstances which may assist in the collection.

The effectiveness of the registered letter is due to its semi-official character. Registry is formal and unusual. When the delinquent debtor receives a registered letter in reference to his account, he will, in most cases, conclude that the matter is becoming serious. He knows that the letter was registered and that he has signed a receipt for it, but he does not know why this was done, or what use is to be made of the receipt. His imagination is then apt to prove a valuable ally for the collection manager. It is al-

ways a distinct point gained when a delinquent debtor can be brought into personal touch and to a formal recognition of the fact that his debt exists; and this a registered letter will, in most cases, bring about.

14. *Telegram.*—In any written communication relating to an indebtedness much care must be taken to avoid liability under the laws against libel and blackmail. Anything written is "in black and white" and if it goes beyond the limit of the law, the sender has himself supplied proof for his own conviction.

This caution is still more imperative with regard to an open communication, such as a telegram, than with a letter, for here the lines are much more closely drawn. The telegram is, in a sense, public property, and about all that can be safely contained in it is the inquiry, when may the remittance be expected. It is interesting to note that the Western Union Telegraph Company in certain of its circulars designed to promote the more general use of telegrams in business has suggested a long list of messages which may safely be used in the collection of accounts without overstepping the bounds prescribed by law.

If used at the proper time a telegram is often very effective, general tho its wording must be. Perhaps a special letter has been written strongly urging payment of the account in whole or in part. The telegram may then be used as a follow-up, tho in form, perhaps, merely a reminder, such as "Wrote you on the 25th. When may we expect a remittance?" or something of that sort.

In many cases a telegram undoubtedly does have the desired urgent effect. The fact that it is ordinarily used only for emergency business gives it greater weight than other forms of communication. The cost is small, and if there is any prospect of its producing results, it may well be tried.

15. *Discussion stage.*—Assuming that as the result of efforts expended in the notification, reminder and reproach stages a reasonable percentage of the slow and delinquent accounts needing attention have classified themselves by either paying or explaining, the fourth stage of collection procedure—that of discussion—is reached for such claims as continue to resist all efforts.

At this point the handling of the account will ordinarily be removed from the routine of the department and be placed in the hands of the collection man himself. His immediate object will be to find out "what's the trouble?" When he has decided upon the measures necessary to apply at this stage, he will take pains to explain to the debtor exactly why he is taking them, in order to give proof that he is fair, even tho severe. His object is to put the debtor on the defensive in any discussion of the matter which may be provoked.

The chief object of the discussion stage is to draw out some sort of an explanation of the delinquency, if not a payment of the account. If a reply is received it is comparatively simple to decide what to do. At this point the collection man gets a real

chance to show his skill in the curbing of delinquency and the straightening out of misunderstandings or difficulties of all kinds. With all the records before him he can size up the debtor and then determine what the collection procedure shall be from that time on. Naturally, if the record of an account gives a hitherto undiscovered clue to the possible explanation for its condition, it will be useful at this stage.

16. *Defective remittances.*—Knowing that the habit of nonpayment grows from small beginnings, the collection man is keen to pick up any trifles which for one reason or another interrupt the regularity of payments on schedule time. He is, for example, suspicious of defective remittances. If checks or exchanges are received without proper signatures or endorsements they must ordinarily be returned for correction and so are conducive to bad payment habits.

Cases occur when such defective remittances have been made with deliberate intent on the part of the remitter. He anticipates that when the omission is discovered his check will be returned to him for signature or indorsement; that he can hold it a day or two before returning it, and that he will thus gain the time consumed in transit and the time that the check is in his hands. The total interval in the case of far-distant points sometimes aggregates between two and three weeks.

The following courses of procedure have been found effective in dealing with defective remittances:

1st. In cases where check is not inclosed in the letter, make a draft for the amount specified, pin it to the letter, deposit them in the regular account and notify the debtor why draft is made.

2nd. When checks are wrongly made out, write on the back over your signature "amount guaranteed," mentioning the correct amount, attach the letter and deposit.

3rd. When the check is not signed, write over your signature "within amount guaranteed," attach to the letter and deposit.

4. When checks or drafts to the remitter's order are not endorsed, examine the letter carefully and supply the endorsement yourself as agent, and deposit, retaining the letter as your authority to do so.

A creditor is sometimes embarrassed by receiving a check marked "in full of account" where as a matter of fact the amount of the check is less than the amount due. Shall he deposit it and if he does so does he waive his claim for the balance? He certainly would lose his right to the remainder if the total were in any way in dispute. On the other hand, if there is absolutely no question as to the amount due such a check does not settle the claim, and if the creditor deposits it he is not debarred from suing for the balance. This is the general rule, but some states [1] have regulated the matter by statutes which should be consulted.

In suggesting this last method it is assumed that, under the conditions stated, authority is clearly given.

17. *Writing to the debtor's business acquaintances.*—When a delinquent refuses to answer com-

[1] For all matters affecting state legislation, the *Credit Man's Diary* published annually by the National Association of Credit Men is a useful guide.

munications but is known to be still in the same location, and the creditor concern has or can secure the addresses of business or personal friends, references or connections of the debtor, it is sometimes very helpful to intimate to him that, if no response is received to its letters, the concern will write to one or more of these persons, merely, of course, to secure information of the debtor's whereabouts. This will often bring a reply, but if it fails to do so, it is then entirely permissible to write to any one who may be in a position to help, explaining that the delinquent is indebted to the concern, that letters written to him had received no attention and asking for information as to his whereabouts. This procedure may bring a certain amount of pressure to bear upon the debtor which will lead to payment of an account. It may happen, also, that friends or relatives will pay such an account themselves rather than allow the matter to become public, and this is especially likely when the debtor has resorted to underhanded or fraudulent means of evading payment.

18. *Tracing moved debtors.*—One of the problems of every collection manager is to trace debtors who move about frequently and who forget, purposely or otherwise, to give any notice of such intention to move, or to leave any information of the new address.

Almost any method of tracing demands concealment of motive. It is futile in attempting to get information regarding a "skipping debtor" to tell his

friends or neighbors that you have a bill against him and you would be obliged to them for information leading to his address.

Inquiries made of neighbors and nearby business houses, banks or concerns with whom he was known to be doing business should produce results. A man who has lived in a neighborhood rarely leaves it without having formed some acquaintances or connections, business or otherwise. The object of the tracer is to find these connecting links. Those acquainted with a debtor are willing to do him either a good or a bad turn if properly approached by one acting in the capacity of an investigator into the debtor's credit. Many men leave disgruntled and dissatisfied acquaintances behind. Their reports are as full and complete as the reports of those who are friendly to the debtor and who wish to give him a good character. Both usually give voluntarily the present or possible address of the man sought.

19. *Tracing thru National Association of Credit Men.*—Probably the best means of country-wide tracings of debtors is afforded thru the medium of the National Association of Credit Men and the pages of *The Credit Monthly,* which lists the names and the particulars of persons wanted. Circulating as the *Monthly* does among thousands of credit men all over the country, it is possible for a creditor in one section of the continent not only to secure information regarding delinquents who have "skipped" but at the same time to warn others against the possibility of

themselves becoming involved with them in the same way.

20. *Tracing thru the post office.*—There is a postal regulation, Sections 551 and 560, Postal Laws and Regulations of 1893, which supplies a useful means for tracing lost debtors.

Under this regulation, the creditor may provide himself with a rubber stamp, to be used on the face of the envelop containing his message to the debtor, which reads like this:

POSTMASTER

See Sections 551 and 560, P. L. and R. 1893
Give reasons returned.
Check one of the following reasons:
Refused
Unclaimed
Cannot be found
Present address unknown
Removed to

Ordinarily the letter carrier or post office will give little information regarding the forwarding address of any one who has moved, because it is against the postal laws to do so. Registered letters will not bring back a receipt from the person sought unless the face of the envelop bears the words "Receipt Requested" and then it does not contain any definite information as to the address at which delivery was actually made.

While the postmaster cannot legally give the change of address of any one, yet, if a collection manager's mailing list for a given city is sent on to

him for the purpose of correcting addresses, he is permitted for a fee of 40 cents an hour for clerical labor involved to correct such a list. In this way it is often possible to locate persons who would otherwise never be found.

21. *Reselling stage.*—When the procedure of collection enters the "discussion" stage it also enters almost simultaneously the "reselling" stage except in the cases where thru some special urgency, it seems advisable to press matters quickly to the "unpleasant" or final measures.

It must not be assumed that all effort to "resell" the delinquent should be confined to this one particular point in the collection process, since every step in the whole process of collecting, from the formal statements to the transfer of the account to an attorney should be saturated with good salesmanship.

The reselling effort referred to here does not, moreover, concern itself directly with the goods purchased or with their quality and desirability. It centers itself on the debtor with the purpose of making him feel ashamed of his own neglect by overwhelming him with the evidence that he has failed to play the game altho more than fairly treated. It is proper to call this the reselling stage because, after visualizing all the debtor's circumstances as revealed by the records and credit files, it applies human, personal and direct efforts to sell him a sense of obligation.

Business houses generally have learned that it does

not pay to drive blindly ahead at this stage to more strenuous action without pausing, first, to make sure that the case against the debtor is complete. This is made more advisable because of the heavy turnover year by year in trade which is driven elsewhere because of some house policy that may have failed to take all the circumstances into account. Once having decided to press matters to a conclusion, it is obviously out of the question to revert back to a milder or more conciliatory attitude afterward.

At this stage, then, the collection man's personality, his sympathy, his imagination, his knowledge of business conditions generally and his understanding of them as they may affect the individual debtor must come into fullest play. In the process of handling an account during this stage, the collection man may make use of all the devices common in earlier stages if by so doing he feels that he can get results. Sometimes the reselling effort will take the form of earnest constructive suggestions, hints for improvements in a customer's business methods or practice. Many times when such plans have been proposed and then followed consistently the customer has been able to work out his own salvation, with the result that he becomes an everlasting friend of the house which helped him in his trouble. The building of good-will resulting from such reselling efforts richly repays the pains and efforts taken.

REVIEW

In requesting payment what two main groups of motives can be relied upon?

What are the usual stages in collection procedure, and what is the significance of each?

Describe the various ways in which drafts can be used.

What rôle may telephone and telegraph play in collection procedure?

How are defective remittances handled?

What can be done when the debtor ignores all requests for payment?

CHAPTER XVI

UNFRIENDLY STAGES OF COLLECTION

1. *Advisability of extreme measures in collecting.* —In spite of the efforts that may be expended to effect a settlement of all delinquent accounts thru the collection stages which have been characterized as "friendly," every business house has to deal with debtors who for some reason or for none at all refuse to pay any attention to the various invoices, statements, drafts or letters designed to bring about a payment or to elicit an explanation with a promise to pay. These cases call for more strenuous treatment than any that have gone before and the collection man must then decide how strong will be the pressure he can afford to exert and how it is to be applied.

He realizes that when accounts must be followed to the last extreme of unpleasantness to secure payment, even tho the money is finally collected the active animosity of the debtor himself must be incurred. The result, moreover, may be the loss of further patronage and also of good-will if this debtor has any following or influence in his neighborhood and trade. It is also certain that the cases which will not lend themselves to settlement, except on the imminent threat of legal proceedings or of legal action itself, will entail

an actual loss of time and money and this may be greater than the amount of the debt involved.

Considerations, however, outside of the actual collection of the money due, sometimes make it necessary for the creditor to push the matter to its logical conclusion as a matter of principle.

2. *Final stages of collection procedure.*—When it is assumed that all reasonable efforts to bring about the settlement of an account thru an explanation of unusual circumstances which may have delayed payment have been resisted, no choice remains but to enter the final stage of collection procedure. Even here the collection man's purpose is to get at the underlying causes of non-payment, and in doing so to force the delinquent into the position where he must pay or explain if he would avoid the inconvenience and the expenditure of time and money which he knows will surely follow legal action.

3. *Black lists.*—Appeals to the fear of consequences from continued neglect are conveyed in the form of veiled or open threats of action to follow. Such threats, however, must be used with the greatest caution or they may defeat their own ends and involve those who use them in most unpleasant consequences.

A common form of conveying a collection threat is that which explains that as a member of a trade or credit association the creditor is required to report all slow and delinquent accounts in order that other members of the association may not suffer loss thru

credit granted to the same habitual delinquents. Such a threat is well within the collector's rights because that is the common practice among cooperative associations offering legitimate protection.

Because he realizes that his account has been neglected without any reasonable excuse, the debtor is usually quick to see the disadvantage of having his name so listed among slow pay customers. This is particularly true since he does not know how wide a circulation such a list may have.

4. *Offering debtor's accounts for sale.*—A practice followed by associations of retail merchants in some localities is to list names, addresses and amounts due on the accounts of all delinquents in the community and after sending out two warnings by letter, to offer the accounts for sale. This plan has been found to work very effectively in New Orleans, where it has been declared legal under the statutes of Louisiana.

5. *House collection agency.*—Assuming that it is necessary to threaten legal action unless the amount of the claim, long past due, is not paid, it behooves the collection man to prepare himself to carry out his threat.

There is a distinct advantage, however, in retaining control of such claims as long as there is the least chance of last minute repentance and payment. It is quite customary, on this account, to threaten quick action by a collection agency or an attorney, but instead of actually referring the claim at once to an outside collection agency, to instal for the immediate

purpose an agency of the creditor's own, whose office is in the company's collection department. Such an agency, as far as the delinquent is concerned, has all the appearance of an independent organization devoting itself to the collection of difficult accounts, bringing legal action and performing other work of that kind. Suitable letterheads and stationery are prepared. A brief new series of letters is written with care to make them altogether different in phrasing and appearance from the house letters the debtor has been accustomed to receive.

The following is quoted from such a letterhead of a house agency to show how the letterhead may serve to throw disquiet into the heart of the delinquent. This was printed across the bottom of the sheet:

> Confidential reports of all bills handed us for collection, giving the names and addresses in full, to protect merchants from giving credit to irresponsible parties who are making no effort to pay their honest debts, are furnished by us daily to merchants and professional men in————————City and County.

Care should be taken, however, not to overdo this sort of thing to the point where the debtor may suspect its genuineness.

The advantage of the house agency lies in the fact that a certain percentage of these "last ditch" accounts will be brought to time by the business-like display of the intention to use force.

When it finally becomes necessary to refer cases to outside attorneys or collection agencies, some house attorneys ask the outside attorneys to divide the fees

with them and then turn their share over to the house. This practice violates the ethics of the legal profession.

6. *Final notice before suit.*—It is customary to devote the third or fourth letter in the house agency series to a "final notice before suit," which will mark the real limit to the debtor's chance to avoid legal action.

Sometimes this notice takes the form of a semi-legal document drawn to represent, in the eyes of the uninitiated, a formal summons to pay. The use of a form even remotely resembling legal phraseology or arrangement is to be avoided. It is doubtful whether it is any more impressive to a delinquent customer, who has the intelligence to see behind its mask, than a brief letter, crisply phrased, to the same purport.

7. *Utilizing the bad check laws.*—It is to be expected that in dealing with any number of delinquents whose accounts have brought them this far in the collection procedure there will be found among them now and then those who have given checks that are later returned by the banks marked "N. G."

It should be noted in passing that thirty-nine of the states now have on their statute books laws dealing very definitely with the debtor who knowingly gives a bad check.

A very effective way of utilizing the law covering such cases has been worked out by collection men and collection agencies who print the text of the statute on cards suitable for inclosing to a debtor who has

offended by way of forceful reminder that he is treading on thin ice.

Such a presentation of the New York law is shown here:

LAWS OF NEW YORK, 1918, CHAPTER 314.

As amended 1923.

AN ACT to amend the penal law, in relation to obtaining money by fraudulent check, draft or order.

The People of the State of New York, represented in Senate and Assembly, do enact as follows:

Section 1. The penal law is hereby amended by adding after section twelve hundred and ninety-two a new section to be section twelve hundred and ninety-two–a, to read as follows:

Sec. 1292–a. OBTAINING MONEY BY FRAUDULENT CHECK, DRAFT OR ORDER: HOW PUNISHED. Any person who, with intent to defraud, shall make or draw or utter or deliver any check, draft or order for the payment of money upon any bank or other depositary, knowing at the time of such making, drawing, uttering or delivering that the maker or drawer has not sufficient funds in or credit with such bank or other depositary for the payment of such check, although no express representation is made in reference thereto, shall be guilty of attempted larceny, and if money or property is obtained from another thereby, is guilty of larceny and punishable accordingly.

In any prosecution under this section as against the maker or drawer thereof, the making, drawing, uttering or delivering of a check, draft or order, payment of which is refused by the drawee because of lack of funds or credit, shall be prima facie evidence of intent to defraud and of knowledge of insufficient funds in or credit with such bank or other depositary. Where such check, draft or order has been protested, the notice of protest thereof shall be admis-

sible as proof of such presentation, non-payment and protest, and shall be presumptive evidence that there was a lack of funds in or with such bank or other depositary.

8. *Selecting an attorney.*—When the time comes for actually referring claims to an outside agency or attorney for collection, it is well to remember that it will still be possible to secure settlement of a considerable number before it is necessary actually to bring suit. The delinquent debtor frequently places too much reliance in his ability to "stall off" a creditor who has been easy with him. A letter at this point may be a perfectly adapted one yet, when signed in the usual manner, fail of its purpose.

Unquestionably most of the effectiveness of handling a claim thru an attorney or an agency lies in the fact that the debtor, having become familiar with the house collection policy, finds himself suddenly in the hands of a stranger. Most people are uncomfortable in unfamiliar surroundings. If, therefore, the same collection letter, instead of being written on the house letter paper, were to be written on that of an attorney, it would be much more pronounced in its effect on certain delinquents because of the unfamiliarity and hence the dread of the unknown.

Thus in somewhat the same way the dread of uncertainty makes the idea of a court action immediately threatening, oftentimes more effective for those who have never been thru the ordeal of a court action, than the action itself is to those who are case hardened by previous experience.

The very fact that by far the greater number of claims which are turned over to attorneys or agencies are actually settled without suit, makes it doubly important in selecting the legal representative to pick men who are amenable to the client's suggestions, who are willing to work with the house collection man and keep his policies always in mind. It may be argued that the attorney or agency should be allowed to follow his own methods, regardless of what they may be, since he is likely to fail if he continues to apply methods dictated by the house policy. In the long run, however, it will be found that the attorney who consistently and intelligently keeps the house policy in mind will do better work and make fewer enemies for the house than the attorney who insists upon a free hand to follow his own plan.

Attorneys and collection agencies include a number of those who are eternally talking "suit" and seem to have no other tricks in their bag. Such men should by all means be avoided as incompetent, because no concern can afford to have its collection man in court any oftener or any longer than is necessary. Experience has shown that court action should not be necessary except in comparatively rare instances.

Some collection men feel that once they have turned an account over to the attorney for collection the matter ends there, as far as they are concerned. This is a mistake, because after all the account still belongs to the house and the attorney is at best only an integral part of the collection machinery.

It may seem too obvious to mention that before selecting the attorney or the agency to entrust with his claims the collection man should make a thoro investigation of his reliability, and his ability to secure the desired results, and of his methods of doing business.

The irresponsible collector may be so slow in paying over the money which he collects that the client will have to resort to criminal proceedings before he can be forced to disgorge. An unscrupulous collector can often do his work in such a way as to result to his own personal gain and to the client's disadvantage, yet not make himself responsible for his misdeeds in either the civil or the criminal courts. Some collection agencies and bonding companies offering attorney lists furnish to each client a surety bond indemnifying against loss thru embezzlement. This appears to be a greater safeguard than it really is. An examination of such a bond will generally show that the entire liability of surety is limited to a few thousand dollars. Should such an agency be doing an extensive business and prove dishonest it might very easily misappropriate a much greater sum than that for which the surety is responsible. Divided among a number of defrauded creditors each one in this case would recover only a very small percentage of his loss. Hence it is far better to investigate the reliability of the collector in advance, and to guard against possible future trouble by refraining from placing business in the hands of one concerning whose integrity there can be any question.

In most localities there are attorneys who specialize in the collection of commercial accounts and who are well qualified to give prompt and efficient attention to claims placed with them. Young attorneys, men recently graduated from the law schools, whose practice is still to be built up, are often found to get better results in handling collections than older men of more seasoned and more varied experience. The younger men need the money and the practice and have a name to make for themselves. For this reason they will often follow collections more closely than is usual with older law firms, which may prefer to devote themselves to other lines of legal work.

9. *Using attorneys in other cities.*—If the claims which are to be referred to attorneys are not merely local but arise in various towns and cities over the country, the problem of handling them takes on new difficulties and complications. In such cases the collection man usually finds it necessary to subscribe for the service of one or more of a large number of attorney lists or directories published by various agencies and bonding companies, and which give the names of attorneys located in practically every town or city on the continent. As already explained, as a part of the service which he purchases, the collection man is protected, to a degree at least, by the bond of the publisher from mishandling or misappropriation of money collected by attorneys whose names are so listed. Under this guarantee he may forward his claim to any attorney on the list.

In order to make the guarantee operative, the following procedure is necessary:

1. See that the attorney selected is named in the current revision of the "Guaranteed Attorneys List" which is usually revised by means of supplements issued monthly thruout the year.

2. Attach a letter of advice to each claim sent to the attorney designated, notifying him that the forwarder is protected by the publisher's bond.

3. Notify the publisher's home office at once on a "Bonding Notice" of the date of forwarding each claim, giving particulars.

A specimen of the "Bonding Notice" mentioned is shown here:

BONDING NOTICE.—
Send this to the Home Office of the U. S. Fidelity & Guaranty Co.
DEPARTMENT OF GUARANTEED ATTORNEYS.
AT BALTIMORE, MD.

..... No. .....
Attorney
Address ..... Date .....
City *State*

CLAIMS VERSUS	LOCATION	AMOUNT

UNITED STATES FIDELITY & GUARANTY CO.,
DEPT. OF GUARANTEED ATTORNEYS,
Baltimore, Md.

We have this day forwarded for collection the above described claim to said attorney, on the faith and by reason of his name appearing in the latest revision of your "Guaranteed Attorneys Quarterly." This notice is a compliance with the requirements of your Bond which we hold.

.....
City.....
State.....

DRAFT DRAWN BY A HOLDER OF THE BOND OF THE

UNITED STATES FIDELITY AND GUARANTY COMPANY

DEPARTMENT OF GUARANTEED ATTORNEYS

Total Resources, over $10,000,000 — Home Office, BALTIMORE, MD.

$..... 19

With Current Exchange

At .....*sight, Pay to the order of the* .....*Bank of*

.....*the sum of* ..... *Dollars,*

With Current Exchange

Value received and charge to account of

.....

Drawer

To ....

Debtor No. Street

Address ....

City State

G. A. Form 258 PATENTED IN THE U. S. JULY 21, 1914

SUBJECT: DRAFT ON

.....

Debtor

OF.....

.....

We take the name of your Bank from the "Guaranteed Attorneys List" of the United States Fidelity and Guaranty Company, Baltimore, Maryland.

DRAWER'S INSTRUCTIONS TO BANK

(To be torn off before presenting)

Gentlemen:

IF OUR ATTACHED DRAFT *on this debtor* IS PAID AT MATURITY, *please* REMIT PROCEEDS *direct* TO US, THE UNDERSIGNED DRAWERS THEREOF, *and* NOT *to the United States Fidelity and Guaranty Company.*

IF DRAFT IS DISHONORED *on presentation* OR IS NOT PAID *at maturity, please* PROMPTLY DELIVER *or mail it* TO THE ATTORNEY NAMED ON THE REVERSE HEREOF.

We enclose stamped envelope bearing attorney's name and address.

$.....

With Current Exchange

PLEASE SEE OTHER SIDE

DO NOT PROTEST

260

STATEMENT

DRAWER'S INSTRUCTIONS TO ATTORNEY

NAMED IN LETTER TO BANK

Dear Sir: Payment of our annexed Draft having been refused, we, the undersigned drawers thereof, hereby authorize you to take prompt action for its collection on the terms stipulated on the back hereof.

Promptly acknowledge receipt and advise what course is best to pursue. Wire, if in your opinion the circumstances warrant.

Do not make any compromise nor receipt debtor in full for any partial payment. Remit all money collected direct to the undersigned by P. O. Money Order, Bank Exchange or Express.

☞DO NOT DETACH FROM DRAFT

Drawer's Instructions to Bank—
Continued

Please deliver to

.....
Attorney

.....
Street

.....
No. Bldg.

.....
City State

Memo. for Bank

.....
Drawer

.....
No. Street

.....
City

.....
State

.....
Date

TERMS STIPULATED FOR THE COLLECTION OF THIS CLAIM BY THE ATTORNEY:

To the Attorney: We hand you this claim, through the Bank named in this Draft, on the faith of and by reason of your name appearing in the latest revision of the Guaranteed Attorneys List of the United States Fidelity and Guaranty Company, and give you notice that we hold said Company's bond. We have notified the United States Fidelity and Guaranty Company that we have placed this claim in your hands, as required by the conditions of said Company's bond. *Your agreement to the terms here stipulated is hereby made a condition precedent to any performance on your part and will be evidenced by your retention of this claim.*

1. Without Suit. 15% on the first $300.00 or less collected.
8% on the next $700.00 or less collected, and
4% on the balance collected in excess of $1,000.00.
Minimum fee, $5.00.
If the claim is for less than $10.00—50% of the amount collected.

2. By Suit. Suit must not be instituted by you without our authority. If suit is authorized, we will advance all court costs; and your compensation is to be a non-contingent suit-fee of not less than $7.50, plus the commissions hereinabove stipulated on the amount collected. If the fee for suit is more than $7.50, it shall not exceed the local customary fee for similar services. In no case, however, is the suit-fee plus commissions to exceed half the claim.

3. If this claim is for goods sold and delivered, and it is settled by our consenting to a return of all or part of the goods charged in the

invoice thereof, your compensation for obtaining such goods is to be as hereinabove stipulated, except that, for the purpose of calculating your commissions, the goods returned are to be regarded as worth only 50% of the value at which they are invoiced to the purchaser.

4. No service justifying any charge other than the foregoing will be begun without notice to us that such service will be undertaken. For such service the charge shall not exceed the local customary charge for similar services.

5. If in your locality, collection fees or rates are established by law or by the rules of a Bar Association, and we are so notified, such law or rules shall govern.

6. No extra charge shall be made for obtaining notes or other security for this claim, if we allow the notes or other security to remain in your hands for collection.

7. If this claim is settled or paid direct to us after an effort by you to collect, you will be entitled to the compensation herein provided for.

8. No charge shall be made by you for unsuccessful efforts to collect, except as herein provided for.

To facilitate suit, if authorized by us, we beg to say that our firm is composed of .....,

We are a corporation under the laws of the State of.....,

.....

In some cases the publisher of the bonded attorneys list provides for certain preliminary collection steps before actually referring the claim to one of its attorneys. For example, if the creditor who has subscribed for their service cares to try the effect of a draft on the debtor thru a bank also named in the list, he will fill out and mail to the bank the instructions shown here. The duplicate mailed at the same time to the debtor carries a letter addressed to him in the upper section instead of the instructions to the bank.

10. *Using a third party to "forward" claims.*—In cases where there are only comparatively few claims to refer to out-of-town attorneys the details of looking after them properly can probably be handled

easily from the creditor's own collection department. Where there are a large number of claims to be dispatched over a wide range of territory, the work of looking after the details may very well assume considerable complexity.

With a view to rendering a very useful service to the collection man by relieving him of the bother of handling such details, certain organizations known as "forwarders" have been organized and are operating with much success.

The forwarder offers the collection man an opportunity to place all his out-of-town collecting in the hands of one who makes a specialty of receiving and forwarding such items. It is the plan followed by many of the larger concerns who do not have an expert collection handler in their own organizations. Such a specialist must be an expert collector himself. He will be in close consultation, by letter and by wire, with the collectors he employs locally whenever he has claims to handle. Thus his client has the advantage of two experienced men working on each claim at approximately the same cost as if the collection man dealt with the attorney direct. Such a forwarder is familiar with the various legal directories, and knows how to pick out the best local collectors. He probably has had other business in the same locality in which the money is owed and the chances are that he will have on his own list the name of a local lawyer there of whom he knows that he can handle the business properly.

He has learned by experience how to force local attorneys to keep him fully informed of the progress made upon work assigned to them, and if his own office is conducted in a systematic manner, he will make frequent and comprehensive reports to his client without being asked for them. This is a great advantage over having to write continually to lawyers scattered all over the country. The expert forwarder soon becomes familiar with his client's business and methods of doing business and knows how he wants the collections handled.

He can quickly detect cases where the local attorney is endeavoring to protect the debtor, and because of friendship, allowing the latter a longer time for making the payments than he is entitled to take. This condition frequently arises, particularly in the smaller towns where the local lawyer personally knows the debtor who owes money. If detected, this situation can very easily be remedied. Because the receiving attorney knows that the forwarder handles a large volume of business and is likely to have future business in the same town, he gives closer and more aggressive attention to such work than to that of scattered clients who are not likely to have occasion again to employ the receiving attorney. This is the usual rule, despite the fact that the business of the forwarder is handled for only part of the regular fee instead of for the entire amount. A reliable and able forwarder of accounts can be readily found. Unless the collection man understands the forwarding busi-

ness as fully as the forwarder himself does, it will be to his advantage to place in the forwarder's hands all out-of-town bills for collection instead of handling them himself.

11. *Using collection agencies.*—The discussion of the means by which the house may follow up its claims thru a third party has made frequent mention of "attorneys" but it should be noted that this function is often performed with equal or even greater satisfaction and dispatch by "collection agencies."

These agencies are sometimes organized simply as an adjunct of an attorney's office for the special purpose of making collections and sometimes as separate copartnerships or corporations for the same purpose. Thousands of such agencies are organized each year only to go out of business after a brief existence. There are many such agencies, however, with long and honorable records behind them, which are capable of doing excellent work.

Since the ethics of the legal profession prevent attorneys from openly soliciting legal business and certain states by statute prohibit corporations from giving legal advice, many attorneys have organized concerns under various titles as collection agencies to accomplish the same purpose. The National Association of Credit Men has compiled what are said to be the most complete files in existence on agencies generally and its information is available to its members without charge. Collection men all over the country are realizing, because of the mortality among such or-

ganizations and the danger of trusting any but those who give evidence of their stability and reliability, that it is becoming more and more necessary to select them carefully.

12. *How the agency works.*—To show how the better class of collection agency works to bring about a settlement of a claim without resorting to legal action, the following is quoted as part of a typical interview of an agency representative with a debtor against whom he had a claim, who had called at his office to explain why payment was refused:

"But just suppose we did send this account back marked 'uncollectible.' The creditor would forward it to some one else, and continue to do so until it was collected. Do you see those rows of files covering the walls in the next room? Every lawyer and collection agency who receives this account will have similar files, and even if they do return it, your name remains in those files with a notation 'Refuses to pay.' The fact that it has already been sent to six is a good example of their persistence, and before you know it, your name will be in the files of every lawyer and credit agency in the city with an unpaid bill marked up against you.

"Suppose you should go to your bank for a loan. Suppose you should want credit extended you. Do you think it would benefit your cause any, if, on investigation—and they always investigate thoroly—they found that every lawyer and collection firm in the city had an unpaid bill against you in their files?

"Another thing," showing the debtor a daily court record, "this paper is the official court record and legal medium of the County. It is taken and read carefully by every bank, attorney and credit manager in the city. Here you will note

in a conspicuous location a column for suits brought on unpaid bills. Every credit man in the city files these papers and when credit is requested, the first thing he does is to investigate whether the applicant has ever been sued.

"Can you afford to make such a name for yourself? Can you afford to have your name printed here? Frankly, now, can you afford not to pay this bill?

"Does the fact that five attorneys have returned this, justify you in refusing to pay what is justly due on a legal contract which my clients are ready and willing to carry out to the best of their ability?

"Here is a blank check, and a pen.

"If you value your good name, your self-respect, and your credit standing, fill it out."

He picked up the pen automatically and wrote a check in full of account.

However all agencies do not act with equal discretion, and one must be careful to assure himself that they follow a correct procedure. In the warning issued by the National Association of Credit Men it is not only a matter of paying money in advance under all sorts of guarantees to certain types of collection agencies who, obtaining all the money on your account, become virtually trustees, but of permitting your own good name to become associated in the minds of even poor payers with concerns of low tone. Plans have been devised by certain agencies for forcing debtors to pay over-due accounts by threatening to publish their delinquency and to advertise the over-due accounts for

public sale. While such schemes may be sometimes effective, it should be borne in mind that the creditor, not the collection agency, lays himself open to an action for damages of libel and of facing a charge for criminal libel or extortion. Such plans are particularly dangerous in New York State, for instance, where it is a crime to threaten the publication of libelous matter. It should be borne in mind that truth is not a defense to criminal libel. Several courts have decided that the use of a system which is intended to force a debtor by threat to publish his debt, and therefore humiliate him to pay his indebtedness, constitutes libel per se.

13. *Cooperating with the attorney or agency.*— When a claim is placed in the hands of an attorney or agency a full and accurate statement of the facts in the case should be given. The collection man knows the circumstances of the transaction with the debtor; very likely he knows something of his past history. He should tell the collector whether the debtor procured goods thru fraud, whether there is reason to believe that he never intended to pay the bill, whether he ever sent or showed a written statement of assets and liabilities which was false. All these facts, which are seldom precisely stated to the collector, may be of importance. If the debtor has been guilty of any such practices the creditor generally can cause his arrest, if he is unable to pay a judgment for the claim. Many a debtor who is supposed to be absolutely "no good" will pay every cent when he is informed that

otherwise he will have to board with the sheriff.

After the creditor states fully all the information he may have in regard to a debtor, he should tell the collector what he wants him to find out. He should find out, for example, whether any judgment or attachments have been filed against the debtor within four months, since he may have to move quickly to put his man into bankruptcy before the four months elapse. After four months the judgments and attachments cannot be upset in this way and creditors of a debtor, often get a preference. If it appears that there are no judgments or attachments, the debtor will often pay the claim, even if he is in difficulties, rather than have his creditors stirred up by the filing of an attachment of judgment. The collector should next see if the debtor has made any personal property mortgages and if they are properly filed. In nearly all states such mortgages must be filed in the town or city where the debtor resides, and in many states such mortgages must be refiled every year or so in order to be valid as against other creditors.

REVIEW

In what form are black lists permissible?

Explain the operations of a house collecting agency.

Describe the bad check laws, and their utility in collection procedure.

Explain considerations in selecting a collection attorney.

Describe the functions of a forwarder.

Is it desirable to bring suit for the collection of debts?

CHAPTER XVII

CREDIT PROTECTION

1. *Measures that guard against loss.*—No matter how careful and judicious the work of the credit department may be, inevitably some proportion of the year's total sales will turn out to have been made to bad credit risks. The credit department, with its investigation and analysis beforehand has done its best to keep this proportion at a minimum, but when the debtor has lapsed in his attention to the account, the collection department must step in to salvage as much as possible from total loss. In addition to the work of the collection department which has been described, what means are open to a house to reduce its losses to a minimum when credit has once been extended?

The methods of securing such protection may be divided into three classes, (1) insurance, by which a part of the risk is shifted from the mercantile house to the company which insures the accounts, (2) methods of adjustment and arbitration without recourse to the laws, and (3) remedies afforded against the debtor by process of law. These remedies subdivide again into the ordinary form of legal action when a simple suit is brought on the account and extraor-

dinary remedies where, under certain circumstances, property of the debtor may be levied upon, the goods themselves may be recovered or the entire transaction set aside.

2. *Insurance against loss.*—In touching upon the subject of discounts in the Chapter on Book Credit, it was remarked that one element in fixing sales prices is the concern's experience with regard to its average losses. The amount of the average or normal loss from bad accounts is definite and easily calculable. Here it is evident that the protection of insurance can have no application. Insurance must be based upon an uncertain event, something which may or may not happen, or upon a happening, the time of which is uncertain. Fire insurance illustrates the first type, life insurance the second. Actual loss in business, however, does not move along in a straight line. There may be years in which the house will have a smaller proportion of losses than usual and years in which the percentage will be much greater than the normal. Here is a possibility, the happening of which is uncertain—the occurrence of unusual losses, and it is in indemnifying against such losses that insurance has a chance to operate.

3. *Credit insurance company work.*—The first step in laying the basis for credit insurance must be the determination of the known quantity, that is, the average or normal loss. For this purpose the applicant's books for a period of years are examined and the percentage of his average losses to gross sales

calculated. This known or normal risk the applicant himself must bear. The normal loss so determined is both a fixed ratio and a movable figure, for fluctuations in the volume of business must be taken into consideration. If the average business of a house is $200,000 and its ratio of losses to gross sales appears on the average to be one and one half per cent, then $3,000 is the initial loss which must be borne by the insured; this figure is the minimum. A year of great activity may drive the business of the house up to the $300,000 mark. While $3,000 is the fixed or minimum initial loss on the average volume of business or less, it is not one and one half per cent of the new gross sales figure, and the risk of the insurance company does not extend beyond the one and one half per cent average. As the volume of sales moves up, then, the normal loss moves along with it and on a business of $300,000 the house would bear losses up to $4,500 before the indemnity of the insurance company becomes operative.

The nature of the insurer's contract guards him against fraud thru granting excessive credit. In the first place, in order to obtain insurance the house which applies for it must be able to pass the test. The insurance company will inquire into its financial standing, its reputation and its methods of doing business. If the applicant qualifies as a desirable risk, the insurance contract is made with these limitations, (1) the fixing of a maximum indemnity, (2) regulations regarding the financial standing of cus-

tomers and, (3) regulations regarding the credit standing of customers.

4. *Conditions of the insurance contract.*—The credit insurance policy is not a blanket coverage against all losses. The company insures up to a certain amount above the average or normal loss. Losses in excess of the maximum, as well as the normal loss must be borne by the insured. Tho all losses are used in fixing the normal, the company will pay no indemnities until the losses "allowable" under the contract as hereafter explained exceed the stipulated "normal" loss.

The second condition referred to in the preceding section relates to the financial standing of the insured's customers. If a customer has a capital rating in Bradstreet's or Dun's of $25,000, there are two restrictions regarding the amount of credit that may be extended to him. Here again the figure is movable as in the case of the normal loss. Varying in accordance with the nature of the business, the amount of credit that may be granted to any one customer is fixed at a certain percentage of his rated worth. Sales to the man with the $25,000 rating, then, may be fixed at a figure not to exceed anywhere from $2,500 to $7,500 or from ten to thirty per cent of his rating.

In addition to this percentage limit on credit advances to the individual customer, there is a fixed limit applying to all accounts irrespective of the customer's rating. This fixed limit takes precedence

over the percentage limit. Accordingly, if the indicated maximum credit is thirty per cent of a customer's rating, but this amount is found to be in excess of the fixed limit per individual account, the insurance company would only be liable up to the latter figure. The fixed limit may be enlarged, if the needs of the business require it, by the payment of an additional premium.

Finally, the policy stipulates not only with regard to the amount of credit but with regard to the character and ability of the debtor. The insurance normally covers only sales to customers who have a good credit rating with one of the two recognized financial agencies. For sales to customers having only a fair rating special provision must be made. This usually takes the form of the company's agreeing to indemnify up to a certain proportion of the sales made, the insured bearing the remainder of the risk. It follows that with respect to good credit risks the insured may be covered, but he obtains only partial indemnity on business with concerns of lower rating.

The kinds of losses against which insurance is available are those arising from the insolvency of the debtor, and the policy defines the acts which are acceptable as proofs of insolvency. The requirements for proof of insolvency are not quite so strict as the acts necessary to be shown in filing a petition in bankruptcy. The proof resembles more the determination of insolvency when goods are stopped in transit, a proceeding to be taken up later in this chapter.

It is not within the province of this book to present briefs either in behalf of or against credit insurance. In behalf of credit insurance the claim is put forth that to a certain extent the element of uncertainty with regard to bad debt losses is removed in advance. The opponents point out that the practice of carrying credit insurance may tend to encourage looser credit methods and interfere with the creditor's freedom of action in the treatment of insolvent accounts. Whether the possible protection the policy affords is worth the premium asked, is of course a question of individual judgment in each case.

5. *Salvaging bad debts thru cooperation.*—When the house is carrying the credit risk without insurance a time may come in the handling of a doubtful account which calls either for legal action, or for intervention in the debtor's affairs to bring matters to adjustment on a friendly basis. Since legal action is always the last remedy to be desired, those means of cooperation and adjustment which do not involve appeal to the law will be considered first.

Inexperience, unwise expansion, lack of capital. frozen credits—these and many other reasons may have weakened the debtor's business and brought it to a state where it is hovering on the brink of failure. Can the patient be nursed back to health? If he can be it is better both for the business and for its creditors, looking at the question wholly from a business standpoint. Lawsuits cost money and assets shrink

at a forced sale. Any enterprise with an even chance of success is more valuable as a going concern than a liquidating one.

The National Association of Credit Men has fostered the organization by its members of local bureaus which have for their object the assistance of any business which gets into financial difficulties, and for the carrying on of educational campaigns. Members of the adjustment bureaus stand ready to lend a hand in arranging the affairs of local businesses which require help. Let us see how this service to ailing debtors operates.

A retailer or manufacturer finds himself drifting perilously near the shoals of insolvency. His position may be learned by a creditor or by a member of the credit association; or it may be that the debtor, on his own initiative, informs the adjustment bureau of how his affairs are going. The adjustment bureau steps in to size up the situation. It will find, probably, bank loans that are pressing, a large volume of trade obligations outstanding, possibly a tangled accounting system, inefficient operation, wasteful expenditures and a host of the other causes that, added together, make for financial embarrassment. The first thing inquired into is the general condition of the business. Is there anything to salvage? If there is, the adjustment bureau acts quickly. There are the claims of creditors to be attended to, for the business must be relieved from pressure. The banks will have the situation explained to them and will be asked to extend

the debtor's loans. Trade creditors will be told the advisability of not pushing their claims immediately and definite extensions will be sought.

Having for the time being relieved the business from the pressure of debt, the next work of the salvors is to get in cash. If the accounts are in bad shape, they will be straightened out and aid will be given in pushing collections. In cases where it seems advisable, the adjustment bureau may also assist in obtaining additional capital for the business. Lack of capital may have been the prime cause of all the difficulty. In general, everything that can be done to place the concern on a good footing and save it from the costly processes of liquidation will be undertaken.

Cases may arise, however, where a business cannot be salvaged, or in which actual or intended fraud in disposal of a firm's assets is scented. In the case of a business which cannot be placed upon a paying basis, an effort is made to have creditors agree to a pro rata settlement at so much on the dollar. The proprietor loses nothing by the arrangement. He has failed anyway, and the creditors will receive more than by letting him go thru bankruptcy. Actual or intended fraud may call for various actions and the adjustment bureaus use their best efforts to thwart anticipated sharp practice of this kind.

Many trade associations undertake the same sort of cooperation. In addition to the practical work performed by bureaus of this sort, their activities are

also suggestive of possibilities for individual creditors. A credit man may have like opportunities for stepping in and helping to save his concern's accounts from total loss. If the amount involved is large, there is all the more reason for the credit man's bestirring himself and taking an active interest in the debtor's affairs. In doing so he is not entering the field of social service; he is extending the field of good business. Any business, unless hopelessly involved and likely to become more so if continued in existence, is worth more to its creditors alive than dead.

6. *Commercial arbitration.*—The substitution of voluntary arbitration between the parties for lawsuits is a method of settling disputes as old as the common law itself. Recently an organized effort has been made to popularize arbitration and to introduce it more frequently as a substitute for actions at law. Some of the States have statutes prescribing the procedure to be followed in matters that are thus voluntarily arbitrated.

Any one who can form a contract can submit a question to arbitration and any legal matter that falls within the jurisdiction of the civil courts, whether relating to real or personal property, may be submitted. If there are no statutes covering arbitration, the agreement to arbitrate may be either written or verbal. If there are State statutes covering the matter, the forms indicated in the statutes must be followed strictly. Any third person not having interest in the subject matter may be chosen as arbitrator.

When a dispute is thus submitted for arbitration, whether in accordance with the State statute or common law rules, the findings of the umpire have the same binding effect as a judgment of a court of law. Arbitration is not a mere getting together of the parties in an informal manner with a referee to act as judge or peacemaker as the need may be. It is a full and complete substitute for an action at law without the possible delays and the certain costs incident to carrying a case thru the courts.

If the State has a statute governing arbitration, the decision of the referee may be enforced by putting it upon record and proceeding under it as on any other judgment. If there is no statute and the arbitration is held under the rules of the common law, a suit for specific performance of the umpire's award may be brought in a court of equity. When the parties have put up bonds to abide by the decision a suit may be brought on the arbitration bond. Most States now have statutes governing arbitration, so that a recording of the judgment and further procedure under it is usually all that is necessary.

Expenses of arbitration are confined to the stenographer's fee and that of the arbitrator. In the majority of business disputes the points at issue are questions of fact rather than questions of law. This being the case, a man fully conversant with a particular line of business is likely to be one who can give a sound and accurate judgment on matters in dispute.

As a saver of time and money, and as a means of getting prompt decision of a dispute commercial arbitration has much to recommend it.

7. *Legal remedies.*—When the other means of collecting or adjusting claims fail, it is time for the last resort, the appeal to the courts. The remedies open to creditors by legal action may be divided into the following general classes: (1) suits brought to enforce payment when the goods have passed into the debtor's possession, (2) rescission of the sale for cause, before the goods have come into the debtor's possession, (3) particular remedies where the element of fraud is present, (4) punishment by means of the criminal law, and (5) actions which take the debtor's property out of his own hands and lodge it in the custody of a receiver or trustee.

In the first of these classes are actions to recover the price of goods sold. This is the ordinary action at law, or an action which is started by levying upon property of the debtor. Rescission involves the right of the seller to stop goods while they are on their way to the debtor and the right of resale of the goods to protect the creditor from loss. The element of fraud permits creditors to set aside transactions where the fraud can be proved. In cases where the debtor makes a blanket sale of his entire stock, it is incumbent upon him and the person to whom he makes such a blanket sale to comply with the statute or fraud will be presumed. The criminal law cannot be used as a means of collecting debts but there are some times

when for the welfare of the business community it may be well to invoke its aid in punishing debtors. Administration of a debtor's property by a receiver, trustee or other officer of a court aims at conserving his assets while adjudication of claims against him is made, or during the winding up of his business and the distributing of the assets among his creditors.

8. *Actions at law.*—Let us suppose that the debtor has had possession of the goods and he has failed to respond to all efforts to induce him to pay for them. The questions come up as to bringing suit for the amount. Is a suit worth while? A judgment is no better than the amount of money that can be realized from it. The first inquiry, then, is regarding the financial position of the debtor, and such information may be obtained in a manner similar to the methods used in testing his credit standing in the first place. This time, however, the question of his credit rating is subordinate to the question of his financial rating. Moreover, a lawsuit always involves a loss from the face value of the account, for while a judgment will cover court costs, the fee of the attorney always comes out of the pocket of the client.

The debtor being found a good "suit risk," there follows the question of proof. As has already been indicated a written instrument, such as a note or an acceptance is most readily capable of proof. It is presumed to have been given for value, and proof of the genuineness of the drawer's or maker's signature and the dishonor of the instrument form suffi-

cient basis for a case. In actions upon book accounts the basis of proof is usually the creditor's books of original entry. A book of original entry is that unit of the party's accounting system where entry of the transaction is first made, as distinguished from ledgers which summarize the transactions entered in the books of original entry. The relevancy and competency of other evidence will be determined by counsel.

Whether possession of the goods has passed or not, if there is a definite undertaking by the debtor to pay on a certain day and he fails to keep his agreement the seller may bring suit. In case the buyer refuses to accept goods, the seller is entitled to recover any loss sustained. By the Uniform Sales Act, damages are measured as the difference between the contract price and the market price at the time the goods should have been accepted. A common form of procedure is to notify the buyer that the goods are held subject to his order and then bring action for the sales price.

9. *Realizing upon the judgment.*—When an account has been reduced to judgment and the judgment entered, it becomes a lien upon the property of the debtor. The lien is enforced by the issuing of an execution, a document which commands the official serving it to levy upon any property of the debtor he may find in his jurisdiction and upon an amount of property sufficient to satisfy the judgment. Statutory exemptions are found in each State which exclude property up to a certain amount, income up to

a certain amount, or implements of trade from levy under execution. If property of the debtor is found in excess of the statutory exemptions, it is levied upon and, in due course of time, advertised and sold at public sale, the proceeds going to defray the costs of the proceeding to settle the amount of the judgment.

If no property of the debtor is discoverable, there are still two means which may be adopted to realize something upon the judgment. The debtor may have no property in his own hands but there may be property to which he has title and which is held for him by another. This property may be in the form of wages due or to become due as well as in other tangible assets. Again, a debtor may apparently be judgment proof and yet have concealed assets. Procedure directed against the debtor's property which is held by another is called garnishment. If the debtor is suspected of having concealed assets he may be required to give an explicit statement of his affairs by means of proceedings supplementary to the judgment.

10. *Garnishment.*—The proceeding known as garnishment is appropriate when a third person either has property of the defendant in his possession or else is indebted to the defendant. Since the defendant or debtor has a right to this property or to the payment of the indebtedness, the effect of the action is to substitute the plaintiff, the creditor, for the debtor defendant and enable the former to satisfy his judg-

ment. Procedure in garnishment is prescribed by statute in the several States. It is necessary for the holder of the judgment to make an affidavit showing cause for believing that the third person, known as the garnishee, has property of the defendant or is indebted to him. The writ issued directs the garnishee to make a full disclosure of the state of facts named in the affidavit and a hearing is held upon the facts disclosed by the affidavit and answer. If the garnishee admits the allegations of the judgment holder, or if he denies them but the facts are sustained by proof, judgment will be entered against him, directing him to pay the judgment holder the amount of the debtor's property in his possession or the amount of his indebtedness to the original defendant, to an amount not to exceed the face of the judgment.

Garnishment need not await the obtaining of a judgment against the defendant in cases where action is started by attaching the debtor's property. In such cases, if a third person is shown to have property of the debtor in his possession it may be garnisheed immediately.

11. *Supplementary proceedings.* — If reasonable grounds exist for believing that the debtor has concealed assets, proceedings supplementary to the judgment may be taken. In this procedure the debtor is brought into court and required to make a full and complete disclosure of his affairs and answer to an examination designed to ferret out any property of his that may be subject to execution. Supplementary

proceedings are useful only if there is reasonable ground for the belief that property has been concealed regarding which there is the reasonable possibility of being able to force some material disclosure, and the amount involved is of sufficient size to make the action worth while.

12. *Attachment.* — While as a general rule suit must be brought and judgment obtained before property of the debtor can be levied upon, statutes provide that in certain cases the action may be commenced by a levy known as an attachment. This remedy is given in cases where the debtor may be able to thwart attempts at suit by evading service of process or where he may be removing or intending to remove his property to another State where it would be safe from any judgment of the court where the action is sought to be maintained. Attachment is applicable also if the transaction upon which the action is brought was tainted with any attempt to perpetrate fraud upon the seller at its inception.

The grounds for an attachment proceeding, therefore, divide into cases: (1) where the debtor is a nonresident of the State or a foreign corporation with no agent in the State, or, if a resident, where he evades the service of legal process or conceals himself; (2) where there is evidence either that the debtor has made fraudulent transfers of his property, is engaged at present in making them, or is contemplating such action; (3) where the debtor plans to remove his property from the court's jurisdiction, and (4) where

there was fraud in connection with the inception of the transaction.

Upon a showing of any of the above states of fact by affidavit a writ of attachment is issued for the seizure of sufficient property of the debtor to cover the amount demanded in the suit. In order to protect the defendant in case the plaintiff fails to make out his case, the latter must give a bond at the time of commencing the action, for the purpose of covering court costs that may be awarded to the defendant. If the plaintiff makes out his case he is then in a position to satisfy his judgment immediately from the property that has been attached.

13. *Creditor's remedies against the goods.*—In case property in the goods has not passed to the buyer, the seller's remedy is less complicated than in cases where title and possession have passed. By the Uniform Sales Act in force in a majority of the States, an unpaid seller has a lien on the goods which form the subject matter of a sale, if, upon expiration of the credit term, they have not been paid for or if the buyer has become insolvent. This lien exists only for the purpose of compelling the buyer to pay the purchase price of these particular goods. A seller has no lien upon goods in his possession to enforce the payment of some other debt that may be owing to him from the buyer.

If it becomes necessary to enforce such a seller's lien, the creditor has two courses of action open. He may rescind the sale and treat the goods as if no

title had passed or he may elect not to rescind the original sale but to sell the goods and hold the buyer for any loss. If it is determined to rescind the sale, a notice of this intent should be given the buyer, altho a repossession of the goods and their subsequent use by the seller is an act tantamount to actual notice. The mere rescinding of the sale does not exhaust the creditor's remedies. After rescission he is entitled to proceed against the debtor for whatever loss or damage he may have sustained by reason of the buyer's failure to live up to his undertaking.

If the course adopted is that of resale, title to the goods rests still in the buyer and in theory the seller makes the resale as the buyer's agent. The best procedure is to give the buyer notice of the intention to resell altho this is not a statutory requirement, and the buyer is entitled neither to notice of the time when the goods are to be resold nor of the place. If, upon resale, the goods bring an amount sufficient to discharge the buyer's debt, the transaction is then closed. If the goods sell for less than the agreed price, the seller may now sue the buyer for the difference between the price he agreed to pay and the amount realized upon the resale.

One more card remains to be played by the seller in certain cases even after the goods have left his possession.

14. *Stoppage in transit.*—When goods have once reached the hands of a carrier such as a railroad company, a seller's lien upon them has expired, for this

lien exists only when the goods are in the seller's possession. If, however, while goods are in transit the seller learns that the buyer has become insolvent, he may stop them in the carrier's hands and regain possession. The two points to be determined with regard to stoppage in transit are regarding the nature of acts which justify belief of the buyer's insolvency and the question of whether or not the goods have come into actual or constructive possession of the buyer.

Actual bankruptcy of the buyer is not necessary in order for the seller to have the right to stop goods in transit. A person who has ceased paying his debts that are due or who is known to be unable to pay them is insolvent within the meaning of the law. The same test applies in Canada, where, altho the Uniform Sales Act does not obtain, the right of stoppage in transit exists.

The goods may not have reached the actual possession of the buyer but the right of stoppage in transit will be lost if they have arrived at their destination and the railroad or a warehouse company is holding them there as the property of the buyer. The right of stoppage in transit is also lost if there is a negotiable bill of lading in existence covering the goods and it has come into the hands of an innocent third party before the seller exercises his right. A bill of lading is a document evidencing title to the goods. If the document is negotiable, that is, capable of transfer from one person to another, possession of the document is equivalent to possession of the goods.

Finally, the right is lost, if the buyer obtains actual possession of the goods whether he obtains this possession rightfully or not.

Assuming that goods are still in transit and that none of the conditions which defeat the right to stoppage exist, the procedure is to notify the railroad company specifying the grounds for stoppage in transit and in this notice directing the company to hold the goods for further disposition by the seller. With the shipment now stopped the seller may proceed in one of the two ways indicated for the exercise of the seller's lien, that is, he may rescind the sale and sue the buyer for any loss or damage occasioned, or he may treat the sale as still in effect but resell the goods as the buyer's agent and hold the latter for any difference between the price realized and the original sale price.

15. *Remedies available in cases of fraud.*—One of the grounds for attachment noticed previously is the existence of fraud at the inception of the transaction. As a basis for attachment this fraud must usually be some written statement containing a misrepresentation regarding the debtor's financial standing and designed to induce the seller to extend credit that would not have been extended except for the fraudulent representation.

Where this is the case and the seller has been induced fraudulently to part with his goods, not only has he the remedy of attachment available but he may bring suit to rescind the whole contract. This action

is valuable only if the goods remain in the hands of the buyer and in any event the burden of proof to establish the fraud rests upon the person bringing the action. If fraud is proved and the goods have not passed into the hands of an innocent third party, the original buyer and seller will be put as nearly as possible in the positions they occupied before the beginning of the transaction.

In cases of fraud statutory provision is often made not only for execution against the goods of the defendant, in case judgment is obtained, but for a body execution. A body execution is similar to arrest in criminal cases and it leads to the imprisonment of the debtor. The grounds upon which such an execution may be issued, and the procedure necessary to obtain it are all a matter of statutory provision, to which reference must be had in each particular State.

16. *Sales of goods in bulk.*—A debtor in straitened financial circumstances who possesses a wriggly conscience usually tries to make one last clean up before he departs for realms unknown. This clean up is likely to take the form of a sale of his entire business to some other party, after which, with the purchase money in his pocket and his debt behind him, he emulates the Arab, folds his tent and silently steals away. The matter may be more involved if he decides to make a pretended sale to someone who is really working with him. Here the property has been transferred and the debtor no longer owns it. What is the creditor to do? The Bulk Sales laws, which exist in

many of the States and the Canadian provinces afford the remedy. By these acts it is incumbent upon a prospective purchaser of a stock of goods in bulk to demand and receive from the seller a list of all his creditors with their addresses and the amounts due. The intending purchaser is then bound to see that the proper amount is withheld from the purchase price to satisfy the creditors. A failure to comply with the statute renders the entire transaction void as to creditors and they may come in and proceed against the goods in the hands of the purchaser exactly as if he were the person who originally contracted the debt. The statement made by the debtor must be under oath and usually notice must be given to creditors either by the prospective buyer or the seller. The Bulk Sales laws cover transactions whereby goods are sold not in the usual course of trade.

17. *Punishment of debtor by the criminal law.*— The criminal law is not designed to aid individuals in the collection of their debts, and the threat of criminal procedure or the institution of a criminal action to induce a debtor to pay is a dangerous undertaking. In the latter case if the debtor does pay and the creditor attempts to have the criminal action dropped he may himself get into trouble for compounding a felony. If a creditor can detach himself from the business aspect of affairs and look at the criminal law as a public-spirited citizen, cases may arise where he will find it his duty to set the wheels of the criminal machinery in action against a debtor who has committed

fraud, without hope of benefitting in any way thereby. A criminal prosecution should be looked upon as an act which may be owed to the business community and not as a weapon for personal gain.

Most of the States have statutes which make the obtaining of goods under false pretenses or by false tokens, such as worthless checks, punishable as crimes. Acts have been passed in a few of the States broadening the scope of these general provisions and providing penalties for the making of false statements to obtain goods.

The New York statute, which is typical of these acts, provides that any person shall be guilty of a misdemeanor who

"shall knowingly make or cause to be made, either directly or indirectly, any false statement in writing with the intent that it shall be relied upon, respecting the financial condition, or means or ability to pay, of himself or any other person, firm or corporation, in which he is interested or for whom he is acting, for the purpose of procuring—the delivery of personal property—the making of a loan or credit, the extension of credit, the discount of an account receivable, or the making, acceptance, discount, sale or indorsement of a bill of exchange or promissory note, for the benefit of either himself or of such person, firm or corporation."

Section 2 of the same statute makes punishable any person who, knowing such a false statement has been made, takes advantage of it by procuring any of the benefits mentioned, and the third section penalizes one who represents that a previous statement would be true if made on the day the representation is given,

when as a matter of fact that statement is no longer true.

18. *Conservation of the debtor's property by the courts.*—There remain for consideration those instances where a court will intervene and take the debtor's property out of his control and administer it thru its appointed representative. As previously indicated, the object of such custody may be either the conservation of the property or its sale and distribution of the proceeds. When the latter is the object the proceeding is that of bankruptcy or insolvency, which will be taken up in the following chapter. The appointment of a receiver in proceedings other than bankruptcy or insolvency is not a usual occurrence and a court will usually take the step only upon very clear proof that the action is necessary. The court's own discretion prevails as to whether the alleged acts and conditions warrant this step. When an action is pending, however, waste or destruction of property owned by the defendant or the wilful dissipation of cash or other liquid assets, which if continued would deprive the plaintiff of any means of enforcing his judgment, may cause a court of equity to place a receiver in charge of the debtor's property. The receiver enters into possession of the property and thereafter administers it in accordance with the general directions of the court.

If waste is not shown, an application for a receiver requires that some lien on the debtor's property be possessed by the petitioner. Application by a mort-

gagee for a receiver of the mortgagor's property during foreclosure is an instance in point. In the case of general creditors, the reduction of their claims to judgment gives a lien upon which the court may be asked to take control of the debtor's property.

REVIEW

Describe the operations of credit insurance. What are its good and bad points?

Explain the operations of adjustment bureaus.

How is arbitration utilized in the settlement of commercial disputes. What are its advantages?

What legal actions can a creditor take when he parted with the goods and the debtor refuses to pay?

What can the creditor do if the goods are still in his possession? or in transit? When do the goods cease to be in transit?

What legal provisions regarding frauds protect the creditor?

CHAPTER XVIII

BANKRUPTCY

1. *What bankruptcy is.*—A century or so ago, a debtor who found himself forced to the wall thru inability to meet his obligations faced a discouraging outlook. He was likely to be arrested, cast into a debtors' prison and left there to languish. This situation was hard on the debtor and it was wrong economically. The debtor had no means of ridding himself of the millstone of debt around his neck and society was being deprived of the productive power of a man who might have come into his unfortunate situation largely thru mischance. Imprisonment for debt, except where the element of fraud is present, passed into disfavor. While this was a forward step, there remained something to be desired from the creditors' standpoint when a man became insolvent.

Insolvency may be either a temporary or an irremediable condition. A man's assets may be in excess of all the money he owes, yet he may not be able to convert his assets readily into cash because of market conditions. Here he is not permanently insolvent but he is in a condition of temporary insolvency. Again, a man may owe considerably in excess of all the property he has to meet his debts.

In either of these situations, creditors must suffer. If a forced sale is made of property, it is unlikely to bring anywhere near its real value. Consequently, forced action in a case of temporary insolvency leads to a state of actual insolvency as the assets melt away thru sale under unfavorable conditions. In real insolvency, by the very state of facts given, all of the creditors' claims cannot be met. Shall they share and share alike in a pro rata distribution of the debtor's property or shall it be a case of first come, first served, with the early comers being paid possibly in full and the less fortunate or alert creditors probably receiving nothing? Shall creditors' interests depend upon this competitive scramble, breeding antagonisms, or shall the system provide for equitable distribution, fostering among creditors the spirit of cooperation which makes possible the free and frank interchange of information so vital to sound credit practice? Bankruptcy laws rest upon the theory that it is better for creditors to share ratably than to make it a race among them, and that it is better for society, when a man has become insolvent, to permit him to give up all he has, discharge as much of his debts as he can and start anew rather than to plod along for years under the discouraging burden of debt.

Bankruptcy then provides that when a man or a company, with certain exceptions, becomes insolvent, he may surrender all his property or his creditors may compel its surrender. The property will then be applied to paying off all his creditors at so much

on the dollar and thereafter, discharged in full from these debts, the bankrupt may start his business career afresh.

2. *The bankruptcy statutes.*—Practically every State of the Union and each province of Canada has its own insolvency laws. These state or provincial statutes are superseded, however, by the national bankruptcy acts in each country. The present United States Bankruptcy Law, passed in 1898, provides a uniform procedure with authority over bankruptcy affairs vested in the United States courts. Canada's General Bankruptcy Act came into effect in the summer of 1920. The effect of these uniform statutes is to do away with the iniquities that might exist if bankruptcy were regulated by a number of varying statutes, with a loophole offered evasive debtors to slip from one jurisdiction to another.

3. *Creditor's interest in bankruptcy proceedings.*—A creditor's interest in bankruptcy as it affects his debtors may be regarded from these angles: First, what is the condition of the debtor? If his affairs can be held together with any reasonable chance of success, it will pay the creditor to use every means to keep him out of bankruptcy thru some of the means of cooperation mentioned in the preceding chapter. If a debtor's affairs are in a bad condition, it may be equally important for the creditor to take counsel with other creditors and move for quick action to prevent any further wasting of the debtor's assets thru either inefficiency or fraud. Finally, when a

debtor has been adjudged a bankrupt, vigilance and good representation are needed by the creditor to discover every asset, to see that the administration of the bankrupt estate is placed in competent hands and that it is made to realize the largest possible amount. The possibilities of attempted fraud by the bankrupt or inefficiency in handling the bankrupt estate demand vigilance on the part of every creditor. Since creditors are often represented by attorneys, care in the selection of the representative is needed. One attorney will often represent a large number of creditors. This is a common procedure since the creditors' interests are the same. If the amount involved is large, consultation and cooperation with other creditors may be advisable, especially if there is a large number of small creditors and only a few large ones. A per capita vote usually controls in the election of a trustee, and since the trustee administers the estate, his fitness is a matter of interest.

4. *Kinds of bankruptcy.*—A person may place himself in bankruptcy or he may be placed there by action of his creditors. The former is voluntary, the latter involuntary bankruptcy. The law provides that persons whose wages are under $1,500 per year and persons chiefly engaged in agriculture can not be forced into involuntary bankruptcy. Partnerships, unincorporated businesses and corporations are also included, the latter class being exclusive of railroad, insurance, banking and municipal corporations. The exception regarding farmers and wage earners is also

found in the Canadian statute.

In cases of involuntary bankruptcy, the petition is required to be filed by at least three creditors whose total claims against the debtor amount to a minimum of $500, and must show that the debtor owes at least $1,000. If there are less than twelve creditors, the petition may be filed by one creditor whose claim equals $500. The same total for claims is required in Canada, but one creditor alone may present the petition. The second requirement for the institution of bankruptcy proceedings is the element of time. In the United States the acts alleged as constituting bankruptcy must have occurred within a period of four months prior to the filing of the petition. In Canada the petition may be filed if the acts complained of were committed within six months prior to the institution of proceedings.

5. *Acts constituting bankruptcy.*—Being wholly a statutory proceeding the petition must allege the commission by the debtor of one or more of the acts of bankruptcy specifically set forth in the statute. The United States statute enumerates the following six grounds.

1. The fraudulent conveyance, transfer, concealment or removal of property with intent to hinder, defraud or delay the general creditors.

2. The transfer, while insolvent, of any part of the debtor's property to any of his creditors with intent to prefer such creditors over others.

3. While insolvent, to permit any creditor to ob-

tain a lien upon his property whether the judgment lien is obtained by acquiescence of the debtor or not.

4. While insolvent, to permit any creditor to obtain a lien, attachment, levy or judgment thru legal proceedings, without discharging the lien, levy or judgment within thirty days from the time it is obtained.

5. Making a general assignment for the benefit of creditors or having a receiver or trustee appointed.

6. The making of a written admission that the debtor is unable to meet his obligations and is willing to be adjudged a bankrupt.

These provisions are paralleled in substance by the Canadian act. In addition, the following acts constitute grounds of bankruptcy proceedings in the Dominion: departure or removal from Canada or departure from place of residence with intent to defeat or delay creditors; removing, secreting or attempting to remove or secrete property with intent to delay or defraud creditors; making a sale of goods in bulk without complying with the Bulk Sales act; giving notice to creditors of actual or intended suspension of payment of debts and failure to meet liabilities as they fall due.

In the case of preferences created by act of the debtor, the act must be intentional in order to afford a ground for bankruptcy. In the case of a preference obtained by a creditor thru legal proceedings, the debtor's suffering of the preference need not be shown to be intentional. In the latter, the debtor

has within five days (in Canada four days) of the time scheduled for sale under execution to pay off the lien. The mere making of an assignment to creditors constitutes an act of bankruptcy. In Canada a voluntary assignment may be made which corresponds to voluntary bankruptcy under the United States statute.

6. *Commencement of proceedings.*—Bankruptcy being regulated by Federal statute, jurisdiction centers in the United States District Court for the district where the debtor has resided or carried on his business for six months prior to the filing of the petition, or for the greater part of that time. In Canada each province is a separate bankruptcy district with a Bankruptcy Court as the competent court for that district.

When the petition of the creditors has been filed and notice duly served upon the bankrupt, he may either controvert the allegations of the petition, admit, or default. If the debtor denies the facts stated in the petition, the creditors have the burden of proving their petition. If proof is made out or the debtor defaults, the court signs the bankruptcy decree and the matter is then sent before a referee, who is an officer of the Federal Court. In Canada a receiving order is made and the debtor's property comes into possession of an authorized trustee.

7. *Protection of assets before adjudication.*—In many actions, especially those where the debtor is suspected of being not above fraud, steps are advis-

able to prevent his making away with property between the filing of the petition and the adjudication. In Canada an interim receiver of the debtor's property may be appointed if such action is shown to be necessary to preserve the debtor's estate. In the United States, the creditors may have a receiver appointed, and this is the most advisable procedure where the bankrupt's business is a going concern or where there are perishable assets, or assets which are readily convertible or removable. Upon putting up a bond and showing due cause, the creditors may also have all the debtor's property seized, pending adjudication, and held in the custody of a United States marshal. An injunction may also be obtained to prevent the debtor's disposing of his property or wasting or destroying his assets in a manner detrimental to creditors. Finally, since the bankrupt's presence at an examination held for the purpose of discovering his assets is most desirable, he is subject to arrest if he tries to escape from the jurisdiction of the court wherein the petition has been filed.

When the adjudication of bankruptcy has been made, the bankrupt has ten days within which to file a schedule listing all creditors with their addresses, the amounts due and owing to each, and a statement of the consideration for which each of the debts was incurred. He files also a complete list of his assets and any claims he has for exemptions. This duty is common both in United States and Canadian procedure.

8. *Proof of claims.*—Unless a creditor has been one of those joining in the petition, his first official entrance into the bankruptcy proceedings comes with his being notified by the referee (in Canada, the trustee) to file his claim, duly verified, and to attend the first general meeting of the creditors. Attention to this notice should be prompt. Any claim, in order to be considered, must be filed and authenticated. It makes no difference whether the claim has been listed in his schedule by the bankrupt or not. The required proof should set forth the nature of the debt, that is, how it was incurred and for what purpose, the consideration received and a description of any securities that may be held covering the debt. If the debt is a continuing account the proof should recite all payments on account and the final verification should be of the debt then actually owing.

If interest is included in the claim, it must be computed up to the time the petition is filed, otherwise, it will not be allowed. The debt may be evidenced by a written instrument of some sort. If this is the case the original document should be attached to the proved claim. Verification may be made either by the claimant or a duly authorized agent, but in the latter case the reason for verification by the agent should be set forth as well as the grounds of the agent's knowledge. Partnership claims may be verified by any member of the firm. When a corporation is claimant, the treasurer or some official discharging the treasurer's duties is the proper officer. His oath

of verification should be taken as an individual.

9. *Classes of claims.*—A creditor's claim may fall into one of three classes. He may be a general creditor, that is, one who has a sum of money definitely owing and not secured in any way; he may be a secured creditor, holding a mortgage or other security which covers his debt; or he may have a contingent claim, such as that of an indorser of the bankrupt's commercial paper. If the debt is not proved by the holder of the paper, the contingent claimant may himself prove the debt.

A secured creditor, provided he obtained his security in good faith and it is not subject to attack as a preference, proceeds directly against the property which his lien covers. He does not participate in the meetings of the general creditors unless he has unsecured claims as well as the debt covered by his lien. In Canada the secured creditor may enforce his security and place a claim for any deficiency or he may surrender his security and make a general claim for the whole debt. A security is also subject to valuation, that is, to redemption by the trustee at its assessed value or its sale in the open market if the trustee is not satisfied with the valuation.

The major part of claims, however, will be those of general creditors who have no security. What claims may be proved and allowed? It is fundamental, of course, that the claim be valid and legal. It must be one ordinarily capable of proof in a court of law. A claim barred by the statute of limitations

would be incapable of proof, for the debtor, by pleading the statute, can prevent its consideration in a court of law.

10. *Provable and allowable claims.*—A claim may be perfectly valid, in so far as its legal status is concerned, however, and still not be provable in bankruptcy. In general all debts where the amount is fixed and certain and where the indebtedness occurred before the adjudication of bankruptcy are admissible. The same thing is true with an indebtedness incurred before adjudication even tho payment of the debt may not be due. If the claim is for an uncertain amount, that amount must be fixed at an exact figure before the claim can be proved. If the claim arises because of some wrong done by the bankrupt, such as an assault or trespass of some sort, however, the claim cannot be proved. Some classes of cases may be construed as what are known in legal phraseology either as actions in tort or on a quasi-contract. Such a case would be if the debtor received goods on consignment, the title not passing to him, and after selling the goods converted the proceeds to his own use. A claim on this ground would be provable since suit could be brought against the debtor on the theory of quasi-contract, that is, the theory that he came into possession of goods or money of another under circumstances where the law implies an agreement to pay. The limit of time for proving claims is one year after the adjudication of bankruptcy has been made. It is to the creditor's interest, however, to prove his

claim as soon as possible.

A claim may be both valid and provable and still be one that will not be allowed. Here the question of whether a claim is a preference enters. Creating a preference has been seen to be one of the acts that afford grounds for lodging the petition in bankruptcy. If a creditor has some security, received within four months prior to the filing of the petition, and was aware at the time of receiving it that he was being preferred, he may be required to give up the preference before having his claim allowed. A creditor who has security for his claim, even tho it may not be subject to attack as a preference, will only be allowed the difference between the value of the security he holds and the face value of the claim.

11. *First meeting of creditors.*—The first conference of the creditors is an important step in the progress of bankruptcy proceedings. It is called by the referee within from ten to thirty days after the adjudication has been made. The bankrupt may be required to attend the meeting and submit to examination, and authority is also given the referee to compel the attendance of friends and associates of the bankrupt who can testify in any way regarding his property. This meeting gives the creditors an opportunity to put the bankrupt thru a stiff examination, and if fraud or concealment is suspected, an able attorney may be able to dig up at the examination useful information regarding the bankrupt's assets. The examination is not subject to the strict rules of

courts of law and considerable latitude is allowed creditors in their efforts to discover the full and exact state of the debtor's financial affairs.

The holding of a general meeting of creditors is also a provision of the Canadian Bankruptcy Act. In both jurisdictions a preferred creditor has no vote unless he has first surrendered his preference. Creditors may vote either in person or by duly appointed proxy, usually an attorney. In the United States the first meeting is of especial importance for it is then that a trustee is elected. This trustee may be any qualified person and it is of course obvious that his fitness is a matter of some importance, for it is upon him that the duties of winding up the bankrupt's affairs and settling the estate will devolve. The vote for trustee is taken both per capita, according to the number of creditors and by amounts in accordance with the total value of claims. In case a difference between the two classes of votes exists, the per capita vote controls.

It will be noted that the Canadian practice omits one of the steps of the United States procedure. Promptly upon the adjudication in Canada the order of reference to a trustee is made. In the United States, the referee intervenes between the adjudication and the first creditors' meeting and the trustee is elected instead of being appointed by the court.

12. *Duties of the trustee.*—With the election or appointment of the trustee, the control of the property passes into his hands. He receives title to all

the assets of the bankrupt for the purposes of his administration. He is entitled to the possession of all the bankrupt's property of whatever kind, and any rights of action for property possessed by the bankrupt pass also to the trustee. If preferences appear to have been given by the bankrupt it is the duty of the trustee to bring action for the purpose of having them set aside and recovering the security. The trustee stands generally in the position of the bankrupt. This position defines the minimum of his powers.

In respect to preferences in the form of liens secured within the period of four months from the date of the bankruptcy and conveyances or transfers of the debtor's property which are tainted with fraud, the position of the trustee is superior to that of the bankrupt. Wherever any of these states of fact exist, it is the duty of the trustee to upset the proceeding which attempted wrongfully to deprive the bankrupt's estate of part of the assets that belong to it. In general the trustee's duties are to reduce all assets of the bankrupt to possession, defend all actions which might tend to diminish the estate, preserve accounts of his transactions and prepare the estate for distribution.

In Canada the trustee has similar powers and duties. Subject to permission from the inspectors who represent the creditors and are elected at the first creditors' meeting, he may carry on the business of the bankrupt, arbitrate or defend matters in dispute, or sell the assets of the bankrupt estate. For most

of the acts of the trustee a separate authorization from the inspectors is required. The trustee's power of sale serves to vest all the right, title and interest of the bankrupt in the purchaser, and in the Province of Quebec sales of real property made in due form are of the same force and effect as a sheriff's deed.

With the written permission of the inspectors the trustee may permit the bankrupt to continue in the management of his property providing the business is carried on for the benefit of the creditors, and he is also empowered to make reasonable allowances to the bankrupt for the support of his family. Both in the United States and in Canada the trustee is chargeable with the duty of keeping accurate record of the bankrupt estate and preparing a report of his activities prior to the termination of the bankruptcy.

13. *Administration of the estate.*—In order that the size of the bankrupt's estate may be known, in the United States three appraisers are appointed to value the assets. If circumstances warrant, the appointment is made by the court before adjudication of bankruptcy; otherwise the appointment is left to the referee. The report of the appraisers, when made, is filed with the bankruptcy court and becomes a matter of record. The duties of the trustee, once he has come into possession of all the bankrupt's estate, are to convert the assets into cash in the most expedient way. If by reason of the nature of any of the assets an immediate sale appears necessary, this may take place even before adjudication and prior to the time

of the trustee's election. Otherwise the sale is made by the trustee upon due notice to each of the creditors. The customary method of reducing the assets to cash is by public sale. If, for any reason, however, it appears that a private sale will be more advantageous, such a sale may be made with the approval of the court. The trustee's conveyance of property is made subject to the approval of the court.

14. *Distribution of dividends.*—During the process of administering the bankrupt's estate and turning the assets into cash the direction of the bankrupt's affairs is entirely in the hands of the trustee. Creditors who have filed their claims will receive a ten days' notice of any proposed sale. Any work of the creditor will be concerned with the interesting of third persons in the sale or possibly an attendance at the sale to try to see that the advertised property does not go at an abnormal sacrifice. Dividends from the proceeds of the bankrupt's estate are made from time to time as the cash balance in the hands of the trustee permits.

The first dividend is required to be made within thirty days from the adjudication of bankruptcy provided the trustee has on hand an amount equal to five per cent of the general creditors' total claims after secured creditors have been paid. Thereafter dividends are paid whenever the trustee has a balance on hand equivalent to ten per cent of the claims of the general creditors. The dividends are required to be at least two in number and the final one cannot be

made within three months from the time of declaration of the first dividend. A further provision is that the initial dividend cannot be for more than fifty per cent of the general claims.

Canadian practice requires the initial dividend to be paid within six months from the time of the receiving order, provided the assets permit, and thereafter dividends are to be paid whenever the trustee has on hand a balance equal to ten per cent of the general claims. If so directed by the inspectors, dividends may be paid more frequently.

15. *Priorities in distribution.*—It has been noted that creditors who have their claims secured are paid before there is a balance applicable to the claims of the general creditors. This, of course, is because the secured creditors have specific liens on property of the bankrupt which are enforceable at law. The general creditors, however, are not on an even footing when it comes to the distribution of the balance. The statutes both of the United States and of Canada prescribe certain priorities among the unsecured claims. Accordingly debts falling within each class are paid in the order prescribed by law. If the amount realized from the bankrupt's estate is insufficient to pay all creditors in full, debts falling into the prior preferred classes may be entirely discharged, while only a small balance per claim will be left over for those whose claims are more remote in the list of priorities.

The United States Bankruptcy Act prescribes the

following as the order in which the proceeds of the bankrupt's estate are to be applied:

(1) The actual and necessary cost of preserving the estate subsequent to filing the petition.

(2) Filing fees paid by creditors in involuntary cases and the reasonable expenses of recovering any property of the bankrupt which has been transferred or concealed.

(3) Costs of administration, including witnesses' fees and attorneys' fees for professional services to petitioning creditors of the bankrupt, as the court may allow.

(4) The expenses of creditors who oppose successfully confirmation of a composition or who procure a composition to be set aside, the amount to be allowed being in the discretion of the court.

(5) Wages due to workmen, clerks or salesmen earned within three months from the commencement of proceedings to an amount not exceeding $600 for each claimant.

(6) Taxes due and owing the United States or any state, county, district or municipality, but no tax on real estate to be in excess of the bankrupt's interest.

(7) Debts owing to any person, including corporations and States and the United States, who by the laws of the States or of the United States is entitled to priority.

16. *The Canadian rule.*—The Canadian Bankruptcy Act establishes the following priorities for the

distribution of dividends:

(1) Taxes.

(2) Rents, in an amount not exceeding the distrainable assets (personal property subject to seizure in distraint) and not exceeding three months rent accrued prior to the date of the receiving order or assignment and the costs of the seizure.

(3) Expenses of the custodian and trustee and fees of the trustee.

(4) Costs of an execution creditor.

(5) All wages, salaries, commission or compensation of any clerk, servant, traveling salesman, laborer or workman for service during three months prior to the date of the receiving order or assignment and all indebtedness under the Workmen's Compensation Law.

(6) Claims resulting from injuries to employes, not covered by Workmen's Compensation Acts, to the extent of any money received by the bankrupt estate from insurance companies as indemnity for the liability.

17. *Effect of discharge from bankruptcy.*—With the liquidation of all the bankrupt's assets and their distribution, the trustee closes the proceedings by filing his final report with the referee, who authorizes the trustee's discharge and refers the matter back to the court. Creditors receive notice of the final meeting and they have the right to have the estate opened for further administration if it appears that there are assets as yet undisposed of.

The bankrupt may apply to the court for discharge not earlier than one month from the time of adjudication, and not later than twelve months, unless unavoidably prevented, in which case he has an additional six-months' time. The discharge is usually a matter of course unless it appears that the bankrupt has performed any of the following acts:

(1) Committed an offense punishable by imprisonment as specified in the act.

(2) With intent to conceal his financial condition, destroyed, removed or failed to keep books of account or records from which such condition might be ascertained.

(3) Obtained money or property on credit or obtained an extension of credit by making a materially false statement in writing.

(4) At any time subsequent to the first day of twelve months immediately preceding the filing of the petition transferred, removed, destroyed or concealed any of his property with intent to hinder, delay or defraud his creditors, or permitted such acts to be done.

(5) Having been granted a previous discharge within six years.

(6) In the course of the proceedings in bankruptcy, refused to obey any lawful order of, or answer any material question approved by the court.

(7) Failing to give a satisfactory explanation of loss or deficiency of assets.

A creditor who shows there are reasonable grounds

for believing the bankrupt has committed any of these acts, places upon the bankrupt the burden of proving the contrary.

The effect of a discharge is to relieve the bankrupt from any and all debts against him with the exception of the following:

Taxes.

A liability incurred thru having obtained property by false pretenses or for wilful and malicious injuries.

Claims which were not scheduled, provided the creditor had not actual notice of the bankruptcy proceedings.

Liability for fraud or embezzlement while acting in any position of trust.

Wages due to clerks, workmen, salesmen or servants which were earned within three months of commencement of the bankruptcy action.

Money owing to an employe which has been entrusted to the employer to secure faithful performance of the employment contract.

Canadian practice permits either a complete or a conditional discharge. The former is more the order and it will usually be granted where the conduct of the bankrupt has been free from attempted trickery and dilatory tactics and where he has cooperated well with creditors and trustee. If cause appears, however, the discharge may be conditional as to time or as to the results of the administration of his estate. Thus discharge may be held up for a period of not less than two years or it may be suspended until the

distribution to creditors has reached an amount of fifty cents on the dollar.

18. *Compositions with creditors.*—It may be to the advantage both of debtor and creditors to make an arrangement whereby a certain amount will be paid by the bankrupt at once and further proceedings in bankruptcy terminated. The initiative in proposing such a composition rests with the bankrupt. He cannot make his proposal, however, before the creditors have had the opportunity of examining him and before he has filed his schedule of assets and liabilities, for naturally the creditors need full information regarding his affairs to determine whether the proposal is acceptable or not.

If a composition is offered by the bankrupt, a meeting of the creditors is called, upon ten days notice, to pass upon the proposal. As in the case of the election of a trustee, vote is taken both according to the number of creditors and according to the amounts of their claims. If both classes of votes result in a majority in favor of the composition, a petition for its allowance is presented to the court. To carry out the composition the bankrupt must deposit either money or property with a designated depositary sufficient to pay the secured creditors, the costs incurred and the amount agreed upon in the composition.

A creditor who does not favor the composition arrangement has the right to oppose the petition at the time set for hearing. His opposition may be based

upon one of three grounds. In the first place he may show that the terms of the composition are inequitable and that the creditors would be benefited by an administration of the estate in due course. In the discretion of the court this may serve to set aside a composition agreement. A second ground for opposition is the showing of any of the acts on the part of the bankrupt mentioned in the preceding section which would prevent a discharge from being granted. Finally a composition may be attacked if it appears that it is not being made in good faith and that collusion exists between the bankrupt and any of the creditors.

In Canada, a somewhat similar provision is found in the statute. The bankrupt may make a formal request of the trustee to call a meeting of the creditors for the purpose of passing upon an offer of composition, or extension of time for meeting his obligations. At the time of making the request he is required to submit a schedule showing his exact financial condition. The trustee then gives creditors due notice of the meeting and with the notice each creditor receives a copy of the bankrupt's statement. A creditor may vote upon the proposal either by attendance at the meeting or by mailing his vote or comment to the trustee. Creditors who make known their opinions in the latter manner are deemed present at the meeting. If the vote in favor of the composition amounts to a majority of the creditors holding three-fourths in amount of all proven debts, the arrangement is

accepted subject to approval by the court. If the composition is approved, the court retains supervision over its execution. It may enforce the terms of the agreement and if the bankrupt fails to carry out the composition, a receiving order may be entered against him upon motion either of the trustee or any of the creditors.

19. *Bankruptcy applied to partnership.*—The unlimited liability of individual members of a partnership for the firm's debts give rise to some rules regarding the bankruptcy of general partnerships that deserve attention.

Due to this unlimited individual liability, a partnership really is insolvent only when the partnership assets plus the assets of the individual members are less than the total of the individual and firm liabilities. Accordingly the petition should allege insolvency in this form and the individual partners are required to file schedules of their separate estates as well as a schedule of the partnership's affairs. However, the creditors of an individual partner, as such, would proceed properly against the individual and not against the firm. The interest of the trustee in the firm's property extends only to the extent of compelling an accounting to determine the extent of the insolvent partner's interest and the inclusion of that interest among his assets. Creditors of the firm can come in and prove their claims against an individual's estate, and the individual creditors of a partner have the same privilege when a firm is thrown into bankruptcy.

However, the direct creditors have first claim in the distribution of the assets. Firm creditors have their claims satisfied from a bankrupt partnership estate before the individual creditors come in, and if any individual is bankrupt, his own creditors are entitled to preference over creditors of any firm of which he is a member.

The claims of creditors of a defunct firm follow the members if they subsequently form another partnership. A petition filed against a partnership may result in the adjudication of the individuals as bankrupts as well as the firm. This would be the case if they or any of them have committed acts of bankruptcy or if they are shown to be insolvent in the course of proceedings.

REVIEW

What is the purpose and intent of bankruptcy legislation?

Distinguish between voluntary and involuntary bankruptcy. How is each type initiated?

Name the acts which constitute evidence of bankruptcy.

How are claims classified, and in what order are they paid?

What is the purpose of the meeting of creditors, how is it conducted and how are votes taken?

What are the advantages of a composition with creditors, and under what circumstances are they allowed?

CHAPTER XIX

THE RÔLE OF THE CREDIT DEPARTMENT IN DEVELOPING BUSINESS

1. *Relation of collection to sales department.*—It is just as foolish to take unnecessary risks in selling goods as it is to take unnecessary risks in buying or manufacturing. But the means taken to minimize the selling risks thru the medium of the credit man and his department are susceptible of a much broader application than has been the practice in the past. The credit man can do a great deal more for the upbuilding of a business than simply to act as a police force to discourage the wrongful appropriation of the company's products.

Among sales managers generally there is perhaps too slight a realization of the important part in general sales policy and strategy which credit and collection methods are capable of playing. Since no sale is complete until the money is collected and in the bank, it follows that the whole credit and collection policy of a business is basically a sales policy. Up to the present time it has been an unwritten law that a salesman must not set foot in the credit department; that the functions of the credit man and the seller of merchandise were as far apart as the poles, and that

the latter might justly regard the credit department with an unfriendly eye. To the salesman the customer was the man who gave him liberal orders and when any of these were declined or even held up for investigation, he felt that the credit manager was a narrow minded individual who cared nothing for the fact that he might be disturbing friendly relations with customers and was never so happy as when depriving the salesman of credit for a sale. Happily this attitude of mutual dislike and distrust is disappearing before a growing realization by both salesmen and credit men that each is indispensable to any real success to be attained by the other.

2. *Every salesman an assistant credit man.*—In a well coordinated organization, looking after credit is not to be considered as a side issue with the salesman, since it is part of his selling. A bill of goods which is not paid for is of no use to the salesman. Why, therefore, solicit orders which are likely to have this result?

Since in business a large proportion of the sales frequently comes thru the men in the field and the profits are derived thru a rapid turnover, it is the function of both sales and credit departments to quicken this turn-over by insuring that credit sales are soon translated into cash.

As selling goods to poor credit risks means a waste of time, the credit man's first duty is to work constructively with the salesmen of the house to make them realize the fact. Too many credit men think

they have nothing to do except to prevent losses after orders are booked by turning down in cold blood those which appear to be questionable without any attempt to show the salesmen the reasons for doing so and thus prompting them to exercise greater care in the future.

Just as the salesman must deal with prospects man to man, a credit man to get the best results must likewise deal man to man with the debtor. The credit man cannot meet each one personally but he can know all that he should know about them if he trains the house salesmen to judge risks and to act as if they were really his assistants at the time the order is taken.

If the credit manager is to help train salesmen to become really useful as credit scouts and do the work of assistants on the credit staff as well as on the sales, he must be well informed regarding all selling plans and policies and work in close harmony with them.

No sales or advertising campaign should be launched that the credit man has not helped in his way to plan. With such relations established there will be no division of interest between the sales and credit departments. Salesmen will soon realize that knowing the customer's financial affairs intimately is as much a part of their business as knowing what the customers want to buy. Under such conditions of joint responsibility selling expenses, as well as credit losses decrease, and sales and profits increase. Lost

motion is eliminated when everybody gets around to the same viewpoint.

3. *Credit man as a salesman.*—This harmonizing of the sales and credit viewpoint, however, is not to be accomplished by words alone. Salesmen will judge from the credit man's actions as well. The latter must know the salesmen intimately and keep them in close touch with everything he is doing which will affect their customers. Salesmen should receive reports concerning them and their accounts. If there is a dispute or threat of trouble it should be referred to the salesman in the territory to get the facts rather than write the customer directly, because the salesman has an intimate personal knowledge of the situation and the credit man has not. Frequently the salesman can give valuable information to the credit man regarding accounts which the latter may deem dubious. If his report does not correspond with that of the local agencies or the attorney then an effort should be made to find out who is right.

Where new territory is being opened it is particularly necessary for credit and sales departments to work in close harmony. It is sometimes possible for the credit man, thru the machinery of his department for gathering information, to prepare the way in advance for the salesmen thru a combing of all prospects listed in the territory, and by securing advance credit reports on them in order to guide the sales efforts most effectively.

4. *Adjusting complaints constructively.*—The credit department, judged in the light of its position to help all other departments of the business and the customers with whom it deals, can be of great service both to customers and the house. Situated as it is in relation to all other functions of the business, the credit desk is the natural place for customers to come with complaints, requests for adjustments, allowances and hard-luck stories generally. Any serious shortcomings of which the house has been guilty in the way of service rendered, deliveries, shortages, defective quality, and the like on which a debtor may hang an excuse for postponing or refusing payment, are naturally brought to the credit manager for relief.

Being given this first-hand knowledge of other people's troubles, what more natural than that the credit man should act as peace-maker. In the process of smoothing over, explaining and making amends for the faults committed by members of the house, he should be the one to initiate constructive measures to help the customer get out of troubles that are due to the fault of no one but the customer himself. The modern credit man is willing to assume this difficult rôle, because it pays to do so. The alternative to a debtor's bankruptcy and the probable loss of money due the house makes it necessary that the credit man be prepared to get on the ground, analyze the customer's troubles and, out of a real fund of tested merchandising experience, help him to get back on his feet once more.

5. *The credit man as a service man.*—After analyzing the most troublesome accounts it is usually found that lack of real business knowledge and experience is the most frequent cause of failure to pay. The customer does not lack good intentions but he either does not know the cause of his own weakness or he does not realize it strongly enough to reform his ways. Often a timely suggestion, if it comes from the man who checks his orders for shipment and at a time when the customer is asking some favor, will do more to work a reform than anything that cold-blooded pressure could ever accomplish.

Sometimes the suggestion will take the form of needed education in the principles of credit. Perhaps it is an accounting system that is needed to show the customer where he really stands. Again it may be the need for more conservative buying or better collection methods. It is not an uncommon practice for the credit man to have a representative, some one experienced in analyzing the conditions which surround a sick business, who can be sent personally to pull a merchant out of a hole. It stands to reason that if this is accomplished the merchant in question is not likely soon to forget the service rendered. It is not necessary, however, to wait until a favorable time to offer help comes. There is literally no end to the constructive suggestions that may come from the credit man before delinquency has had time to develop. They may be offered in the form of dealer help literature of all kinds. As a matter of fact,

many concerns of national importance are working in just this way.

6. *Bringing dead accounts to life.*—While it might be assumed that the task of keeping up a concern's good name and its reputation for quality goods and service is one that naturally falls to the sales or advertising departments, there is nevertheless a distinct credit angle on this work also. Every account on the company's books which is shown to be active is proof of continued satisfaction with goods and service. The fewer cases of dispute or dissatisfaction over service or goods sold the less friction there must naturally be to retard the business growth. It is not the cases of known dissatisfaction, however, that should interest the credit man most. What he should be more concerned about are the cases of which he knows nothing because the customer has simply quit buying and said nothing. Perhaps one of the most fruitful fields for him to cultivate for the general good of the business is the files of customers who have ceased to patronize the house.

With facilities at hand he is in a position to secure information as to causes and conditions which give him the importance of a real first aid to the upbuilding of the business. In retail lines it is quite common to circularize the names on dormant account lists with the idea of recalling to those who once patronized the store, the convenience and advantage of doing so again. The same idea is carried out in the relation of the wholesaler or manufacturer with his customers.

7. *Need for a broad credit policy.*—The credit man has a real personal interest in seeing the buyer thrive. He knows full well that the percentage of credit loss in his department is, roughly speaking, the symbol of his efficiency, just as a sales manager knows that, roughly, the volume of sales is his badge. Which of the two then has the dealer's solvency most at heart?

The credit man knows that an abnormal number of insolvent customers means his dismissal. He also knows that the moment he tries to "play safe" and pass credit only on gilt-edge risks, that same moment the inside and outside sales force will insist on a change of policy or a new credit head—and be backed up in the demand by the board of directors. The sales department has no such narrow bounds. In any ordinary business, the greater the amount of orders turned in from all sources, except those which are manifestly fraudulent, the better pleased will the directors be. It therefore follows that the credit man is apt to be the only individual in the merchandising end of a business who must both keep dealers stocked and keep them solvent.

There is a mistaken notion in some circles that economy consists of doing without things. This is a human and also a business fallacy. Were it sound, machinery would be unknown and hand labor the universal rule. There is a mistaken notion in sales circles that a dealer should be sold only as much as he in turn can sell. On this principle a retailer's growth is decidedly limited. The new thought in

credit management is that the buyer should be made financially sound by buying more—and of course, selling more. The buyer should make a profit as well as the manufacturer, not because the buyer will not buy unless he can see a profit, but because he should not buy unless he can make a profit.

After all, sound finance means as much to the buyer as to the seller, and when the size of the manufacturer's business necessitates the hiring of brains specializing in finance and credits, the by-products of those brains should be sales factors. The technique of credit has improved wonderfully in a decade. The steps toward the abolition of abuses of credit have gone steadily onward. Few, however, have made more than a start toward the broader policy which capitalizes credit as a sales-builder.

REVIEW

What should be the attitude of the sales department to the credit department?

In what sense is the salesman an assistant credit man?

How does the credit man become a service man to the house and to its customers?

Describe the relation, if any, of credit work to advertising.

How may the credit department create good-will for the business?

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